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Business Leadership in the Large Corporation

BY

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WASHINGTON, D.C.
THE BROOKINGS INSTITUTION
1945

Set up and printed
Published January 1945
Second Printing April 1945
Third Printing January, 1947
Fourth Printing January 1948

A WARTIME BOOK

This complete edition is produced in full compliance with the government's regulations for conserving paper and other essential materials.

Printed in the United States of America
George Banta Publishing Co.
Menasha, Wisconsin

PREFATORY NOTE

"Institutional" economists have devoted a large amount of their interest to the study of public or governmental institutions such as fiscal agencies, tariffs, tax systems, regulatory laws, and administrative bureaus or of market structures and practices. These institutional factors external to the firm are of unquestionable importance. But their study should not be pursued to the neglect of what may be called the private institutions of business. These include the company structures, practices, and policies that businessmen have themselves built up and operate within the law set out on statute books and in administrative rulings.

Some five years ago I became aware of the interest that Professor Gordon of the University of California was taking in the structure of the large business corporation in relation to its economic functioning—an interest which went back to his graduate student days at Harvard. This line of research seemed to me so definitely complementary to my own studies in the *content* of corporate management—particularly price policies—that I undertook to bring him to Brookings, where his time would be so freed from teaching duties that he might complete his analysis of the organization of the large corporation as it affects the role of business leadership.

This work was far from complete when the prior claim of war service took all but fragments of Dr. Gordon's time, and completion of the work was considerably retarded. At the same time, the practical business contacts incident to his job in the War Production Board and its liaisons with other war agencies have given him further opportunities to observe, to ponder, and to discuss the relationships of corporation management with which he is here dealing. The book as now printed has no doubt gained from this longer period of preparation and this broader experience.

Dr. Gordon is here writing for both the economist and the businessman. Though his interest in this field developed out of consideration of the theoretical literature on the entrepreneurial function, he fully appreciates that it is more important to know how businessmen actually shape their practices than what the economist thinks or says about them. To the corporate executive it may at first glance seem that the book recites in tedious professorial style only what every businessman knows. It may no doubt be conceded that every top executive is familiar with the superficial facts of most of the relationships that are systematically traced in the book. The point is that he probably takes them too much for granted—either as things which have become established and are not to be questioned or, on the other hand, as practical arrangements that were dictated by casual expediency and that can be immediately abandoned whenever a new expedient is suggested by changed circumstances.

It is a merit of the author's treatment that he seeks to think through with the businessman the implications of present ways of corporate life or the influence they have on the economic performance of private business managers. His treatment implies a belief that the business mechanism is constructed by businessmen, according to designs whose various features must be considered with as much care and professional competence as the design of a motor or the layout of an assembly line. Only so can we have progressive engineering rather than mere Topsy growth.

The current design of big business corporations is considered in terms of its operative functions, but these in turn are related to over-all purpose. Out of this emerges a concept of "business leadership," which is related to the economist's word "entrepreneurship" and the businessman's phrase "private enterprise." Thus in Part I and again in the closing portion of the book we are led beyond the merely mechanical aspects of business on the "institutional" plane to a consideration of the business corporation as organized human activity shaped to

the achieving of certain basic common purposes through procedures that are chosen, devised, guided, and progressively modified by the personalities, major and minor, who are themselves the cogs and levers of the machine. Such personalized, volitional, or psychological analyses of the economic process are beginning to constitute a third type of economic research complementing the "theoretical" and the "institutional."

This brings the author, in his closing chapters, to contemplate the motivation which plays upon these participants in the processes of business administration and the incentives which operate in the current scheme of corporate organization. That calls for reconsideration of fundamental economic forces about which we need more profound knowledge but of which we can get real understanding only as we see men at work in the institutional mechanisms of business. If the author has dealt some stiff blows at traditional theories of entrepreneurship, he has also brought up valuable materials for the shaping of "theoretical" generalizations more realistic and germane to the business world we live in.

Not the least of the author's contributions is his treatment of what he calls "interest groups" and their pressures upon the behavior of business men. The word "control" has been too loosely used in the past and has never been adequately related to the operational patterns out of which major business decisions emerge. Dr. Gordon's analysis throws considerable light on the character of these politico-business forces.

Considering the working model of the large corporation as he has thus set it up, Dr. Gordon notes the decline of the owner entrepreneur, the rise of the professional manager, and the ambiguous position of the "director." This prompts him to suggest one major line of institutional modification, namely a new kind of directorship. But he is not here concerned with possibilities of changing the role of government regulatory agencies or the desirability or feasibility of raising the quality or shaping the outlook of managers. Leaving these factors constant for purposes of the present analysis, he considers a change in the

role of the director which he believes would cause the businessman as we know him to give better business leadership, using the instrumentality of the large corporation as we know it.

Other students may be more concerned with additional possibilities of improving the contribution of the large corporation to business leadership, for example, the demarcation between "labor" and "management" in a system in which professional managers are a particular class of technically qualified workers rather than suppliers of equity capital. It might be profitable to explore possible means and consequences of introducing a system of corporate suffrage open to all classes of workers or to a group larger than that now defined as "management," and to consider the range of matters that would be functionally suitable for referendum to such a voting body. The author's discussion of "interest groups," external as well as internal, should also stimulate further lines of realistic analysis. Finally, his closing comments on the motivation of the professional executive should pave the way for numerous inquiries into the broad field of business policy making.

E. G. Nourse
Vice-President

The Brookings Institution
November 1944

AUTHOR'S ACKNOWLEDGMENTS

More than ten years ago, an excursion into the literature on the entrepreneur impressed me with the lack of information on how business leadership was carried on in large-scale enterprise. Publication at that time of *The Modern Corporation and Private Property*, by Berle and Means, pointed up the importance of the giant concern in the American economy. It likewise whetted my curiosity as to the relation between active entrepreneurship and the "control" allegedly exercised by large stockholders, bankers, and others. After a decade, the present study has resulted.

Detailed research into the history and management of the companies covered was initially made possible by grants from the Committee on Research in the Social Sciences of Harvard University. During my last three years at Harvard (1935-38), the Committee's aid permitted the collection of the major part of the necessary case material and the compilation of statistical data on the stockholdings and the compensation of management. Some of this material provided the basis for several articles, parts of which have been incorporated into the present volume. I am also indebted to the University of California, which through its Institute of Social Sciences financed additional research assistance on the project during the years 1939-41.

Integration of the case material and work on the final manuscript began in 1940 with my appointment as a temporary member of the staff of the Brookings Institution. But some four and a half years have intervened between beginning and completion of the manuscript, chiefly because the demands of a wartime job in Washington have dragged out the process of revision and checking. Consequently, while some attempt has been made to bring the material up to date, the facts described refer primarily to the middle and late 1930's.

Space is not available to mention by name all the businessmen who have generously given of their time to discuss with me the leadership situation in their own companies and also the more general aspects of the problem under investigation. Naturally, not all interviews were equally profitable; I met varying degrees of reticence; but without these interviews I could not have written several of the chapters in the form in which they now stand. All major statements of fact have been submitted to the companies mentioned, and such comments as they have made have been carefully considered; but I have ultimately relied on my own interpretation of the facts in the light of these comments.

I wish to acknowledge the courtesy of the editors of *Fortune*, who gave me blanket permission to quote from various studies of industrial companies prepared by their staff and published in their magazine. My thanks are due also to the *Quarterly Journal of Economics* and the *American Economic Review* for permission to reprint some tables and text from articles of mine which grew out of earlier phases of this study.

Besides Dr. Nourse, the following have been kind enough to read various portions of the manuscript and to offer their comments: Dean John C. Baker, Mr. W. L. Batt, Professors W. L. Crum, Fritz Machlup, J. A. Schumpeter, I. L. Sharfman and Dan T. Smith, and Drs. Lincoln Gordon and Charles Morgan. My wife also has patiently listened, read, and offered suggestions that have improved nearly every page.

A number of young men and women have toiled in various libraries, building the foundation of case studies and statistical material on which the study rests. My thanks are due particularly to Mrs. Constance Day, Miss Lillian Freed, and to Messrs. Philip Beaudry, E. I. Eaton, R. G. Gettell, Theodore Norman, and Caleb Smith.

For all statements of opinion, and for any errors of fact or deficiencies in analysis that remain, I am solely responsible.

R. A. Gordon

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PART III. INCENTIVES AND THE PROFESSIONALIZATION OF BUSINESS LEADERSHIP

PART I

INTRODUCTION

CHAPTER I

THE NATURE OF THE PROBLEM

In the infinitely complex economic system on which we rely for our daily bread, no productive function is more important than that of our business leaders. These men are charged with the responsibility of giving direction and unity to the efforts of the many who participate in economic activity. It is their job to make the plans and decisions which will transform economic effort into the particular goods and services wanted by a myriad of consumers. Conversely, it is their job also to translate consumers' needs into employment opportunities for labor and other economic resources.

In a private enterprise type of economic system, we call these economic leaders "businessmen" or "business leaders," and we may speak of their directing and co-ordinating function as that of business leadership.[1] The purpose of this study is to examine the way in which this highly important role is actually performed today in the giant corporation, which has in many respects become the dominant type of business enterprise in the United States. Who are our business leaders in the large corporation, and under what sort of conditions do they perform their leadership function?

THE NATURE OF BUSINESS LEADERSHIP

Let us consider briefly what we mean by business leadership.[2] Direction and co-ordination are required in any type of economic system that has progressed beyond the stage of self-sufficient family units. If we have division of labor and production for a market (even though the needs of consumers are not evaluated through the price mechanism), the necessity

[1] We might also call these men *entrepreneurs*. The reason we avoid this term is indicated at a later point.

[2] In this section we present a rather generalized statement of the nature of the leadership function. In Chap. 3 we shall indicate in some detail exactly what types of decision-making we include in the leadership function.

for the integrating and guiding role of economic leadership exists.

This function may be exercised in different ways. In a completely socialist system, government officials would perform it.[3] In a free enterprise system, the function is carried out by those who direct the affairs of individual business firms. These men may be the owners of their enterprises. They may be paid executives, directors, bankers, or stockholders. In the very small firm, the function may be entirely performed by a single individual. In a large corporation, it is more likely to be shared by a group. Production for a market in a changing and uncertain world creates the need for leadership. But a variety of conditions determines how and by whom that role will be exercised at a particular time and place.

Today, in the highly developed economic systems of the Western World, the men who perform the leadership function stand at the center of the productive process. Upon them converge the demands of consumers, which the business leader evaluates and translates into offers of employment to labor and the other productive agents. He determines what should be produced, in what quantities and at what prices, and he is also responsible for determining the methods by which production should be carried on. Because of his position at the center of the productive process, he acts as the agent through whom the national income is distributed to those who participate in production.

In a world of change and uncertainty, the business leader becomes a vital element in the very process of change itself. As demand shifts or as new developments occur calling for

[3] The needs of consumers must be analyzed and evaluated by those in charge of production. The criteria for evaluating needs depend upon the economic and political system within which production takes place. In a system of free enterprise, they are primarily price and profit. Where production is by government order, the criteria may be several: the welfare of the state (from any of a number of different points of view), the requirements of individuals (again according to some standard of need), or even the same sort of price and profit calculations, based on consumers' freedom of choice in spending their money incomes, which prevail in our present system.

new methods of production, these (and other) changes show themselves in our present system in the form of altered price relationships and profit expectations. The business leader is the one who detects and evaluates the new situation and directs the making of such adjustments in the economic system as seem necessary to him. The business leader also *creates* change: discovering new markets, introducing new products and new productive techniques, and so on.[4]

Business leadership, then, is the function of organizing and directing business enterprises, of making the decisions which determine the course of a firm's activities. By administering individual undertakings, business leaders taken together direct the course of activity in the economic system as a whole.

Many economists would give the title *entrepreneur* to the business leader and would refer to what we have called business leadership as the entrepreneurial function. The word entrepreneur, however, has been given a variety of conflicting definitions in economic literature. Fairly generally, the "entrepreneur" is considered to be not only what we would call a business leader but also the owner of the enterprise. Sometimes the entrepreneur's function is regarded as risk-taking rather than leadership. When the emphasis is placed on leadership, there is no general agreement as to how much actual decision-making is encompassed in the entrepreneurial function. To some economists, the entrepreneur is the "supreme co-ordinating authority" but not the man to whom important elements of decision-making may be delegated. To others, entrepreneurship might include most of the kinds of decision-making which we would include in the leadership function.

The most serious lack of agreement among economists in

[4] This paragraph can be summarized by saying that the business leader's (entrepreneur's) active function is the dual one of adjustment and innovation. See Maurice Dobb, *Capitalist Enterprise and Social Progress* (1925), Chap. 3. Joseph A. Schumpeter, however, who has contributed much to the study of economic change, would include only innovation, the creation of change, in the entrepreneurial function. See his *Theory of Economic Development* (1934), Chap. 2, and *Business Cycles* (1939), Vol. 1, pp. 102 ff.

their definitions of the entrepreneur arises in connection with the large corporation, in which the owners are not the active leaders and in which decision-making is diffused and delegated through a hierarchy of directors and management officials.[5] But it is in the large corporation that we want to examine how business leadership is performed. To avoid misunderstanding and controversy, therefore, we shall refrain from speaking of the entrepreneur and use instead the expressions "business leader" and "business leadership." The general nature of the function we have in mind when we use these terms has been indicated in the preceding paragraphs.

THE SIGNIFICANCE OF THE LEADERSHIP FUNCTION

Obviously, the businessman is not independent of his environment. His course of action is strongly conditioned by a wide range of environmental pressures which bear upon him. Does this mean that the business leader is purely a passive agent, reacting mechanically to market and other pressures? This question deserves further investigation.

In a price system, the business leader relies on the price offers of consumers to know what and how much to produce. Similarly, he is faced with certain facts concerning the supplies and qualities of the factors of production, and to these also he must adjust himself. The state of technical and economic organization presents further conditions to which the business leader must adapt himself (although one effect of his leadership activity is to bring about changes in these conditions).

Finally, the institutions of the economic and political system within which he operates set limitations on the scope and direction of his leadership. In a free-enterprise system, the competition of other business leaders is a powerful conditioning force—both in limiting the range of entrepreneurial discretion and in affecting the manner in which business leader-

[5] On all this, see R. A. Gordon, "Enterprise, Profits, and the Modern Corporation," in *Explorations in Economics: Notes and Essays Contributed in Honor of F. W. Taussig* (1936), pp. 306-16.

ship will be exercised.[6] Important also as a conditioning force are the pressures exerted by various interest groups which seek to wield power over the enterprise. These group pressures range from the regulatory activities of government to the power and influence of banks and other financial interests, organized labor, large customers, suppliers of strategic materials, and so on.[7]

In a system of private property and free enterprise, the business leader is expected to make his decisions with the aim of maximizing the profits of his firm. In what direction the search for profit will take the business leader will depend upon the technical conditions of demand and supply and the other restrictive influences mentioned in the preceding paragraph.

The fact that businessmen, in pursuing the end of maximum profits for their firms, must adapt themselves to changing market conditions led the classical economists (and many modern ones) to look upon the business leader (entrepreneur) as a purely colorless medium, through which stimuli were transmitted to various parts of the economic organism. Thus the entrepreneur was assumed to be a passive agent, reacting to his environment but not in turn having an independent influence of his own. In this way, economists have been able to concentrate upon "underlying forces" and to assume that these forces automatically had certain definite and foreseeable

[6] We speak here of both price and non-price competition. Even in the largest-scale enterprises, actual and potential competition strongly conditions leadership activity. This is not to deny that businessmen strive to control competition. Thus far, in this country, they have been more successful in keeping price-competition in check than in curbing the sort of competition which emphasizes various forms of sales promotion. This, in a way, is a good example of how the business leader and his environment mutually react upon each other. The attempt to avoid price competition by business leaders has had a profound influence on the nature of competitive practices and the conditions under which productive activity is carried on. This change in the nature of competition has tended, of course, to increase the range of discretion open to the business leader.

[7] The whole topic of "institutional controls" and economic pressure groups in relation to the exercise of the leadership function is discussed in some detail in Chaps. 7-11.

effects upon the economic system. This method of mechanistic analysis was facilitated, or rather made possible, by the classical assumptions of free and perfect competition and of perfect economic rationality (the latter defined to mean the automatic pursuit of the largest possible gain to be secured from alternative lines of action open to the individual).[8]

While it is perfectly true that the business leader's independence is circumscribed by a given economic environment, this does not mean that he is entirely a passive agent who reacts automatically and in predetermined fashion to events as they occur. Actually, the business leader plays an independent role of some importance. Profit may be the guiding motive; but economic situations must be translated into profit possibil-

[8] The tendency among economists in this regard has been well stated as follows: "In classical and neo-classical economics, entrepreneurship has figured chiefly as a pervasive reality which, once admitted in the premises, may then be dropped from the field of vision. . . . It has been recognized that the choices of the entrepreneur set the whole productive mechanism in motion. But these choices, according to the usual view, are mere matters of calculation, and involve no element of will or feeling. . . . The entrepreneur's existence as an economic man depends upon his acceptance of every opportunity to better himself, even in the least degree, by his choices. Accordingly, it is not to the choices themselves that orthodox economics looks for an explanation of price changes, but to the forces that determine the respective magnitudes of the items offered for choice." (A. S. Johnson, "Davenport's Economics and the Present Problems of Theory," *Quarterly Journal of Economics*, Vol. 28 (1914), pp. 422-23.) Not all economists, of course, fit this description. Among those who have ascribed greater volitional importance to the entrepreneur are Veblen, Davenport, Hawley, Schumpeter, and Dobb. In recent years, two tendencies in economic analysis have had opposite effects upon the role which economists attribute to the entrepreneur. Developments in mathematical economics and general equilibrium theory have reinforced the mechanistic approach to entrepreneurial activity. On the other hand, the recent analysis of imperfect competition and the consequent emphasis upon the factors affecting the price policies of firms have tended, if only by implication, to ascribe volitional importance to those engaged in leadership activity. (See in this connection, E. G. Nourse, "The Meaning of 'Price Policy'," *Quarterly Journal of Economics*, Vol. 55 (1941), pp. 175-209; A. R. Burns, "The Organization of Industry and the Theory of Prices," *Journal of Political Economy*, Vol. 45 (1937), pp. 662 ff., especially p. 666; and E. S. Mason, "Price and Production Policies of Large-Scale Enterprise," *American Economic Review*, Vol. 29, Supplement (March 1939), pp. 61 ff.) Another development which has tended, again if only by implication, to stress the importance of leadership decisions has been the emphasis on business expectations in recent monetary and business-cycle theory.

ities. A given situation may lead to any one of a number of courses of action, depending on how this process of translation is performed. Not only the character of the businessman but also the particular organization for leadership within which he operates makes a difference. Economic leadership in the giant corporation is not the same thing as in the relatively small-scale one-man concern. The techniques of decision-making are substantially different in the two types of organization. So are the incentives to which the business leader reacts.

Further, the profit motive must be pursued within the limits imposed by the institutional restrictions previously mentioned, for example, government regulation or the pressures exerted by various economic interest groups that acquire power over the enterprise. These institutional pulls, as well as prices and prospects of profits, make up the environment to which the business leader reacts. The economist ordinarily ignores such institutional factors. But they cannot be ignored if we are to understand how business leadership is actually carried on.[9] We cannot dismiss the business leader as the passive means of transmitting underlying market forces to an economic system which mechanically and in predetermined fashion reacts to these forces. All the conditions surrounding the exercise of the leadership function become additional variables which must be included in an analysis of the operations of the economic system. In view of this, and in view of the dynamic importance of the business leader's function, it becomes highly important that we ascertain the actual conditions under which business leadership is carried on today and the effects which this leadership, so exercised, has on the operation of our economic system.[10]

[9] Nor can we ignore purely psychological determinants of entrepreneurial behavior. Economic behavior which may be completely incomprehensible in terms of the usual profit-and-loss calculations may become easily understood when considered in the light of such incentives as the desire for power, the creative urge, or loyalty to a group. See Chap. 13.

[10] A further set of problems is raised also but cannot be treated in this study. Acquisition of the power necessary to exercise the leadership function

PROBLEMS RAISED BY THE LARGE CORPORATION

From many points of view, the large corporation—not the small or even medium-sized concern—is the most important type of business enterprise in the United States.[11] Many industries are dominated by one or a few huge firms; thousands of workers may depend for their livelihoods on the activities of a single concern. On the men who guide these relatively few large undertakings depends the economic welfare of millions: consumers, workers, large-scale and petty capitalists, and, indirectly through the ramifications of the network of price and profit relations, a host of smaller businessmen. What we have said about the importance of the business leader holds most clearly for the men who direct the affairs of these giant undertakings.

This being the case, we should know the answers to such questions as the following: What has happened to the leadership function as the old-fashioned type of one-man business has declined in relative importance and as vast corporate bureaucracies have taken its place? What, in fact, does business leadership mean today in a world of divided responsibility and delegated authority, in which "hired managers" make basic business decisions and in which many business owners (stockholders) scarcely know what their firms produce? Which types of decisions and activities should be included in the leadership function, and which excluded? Given the particular types of leadership activity and decision-making

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implies acquisition also of some measure of influence over the activities of those who co-operate in production. How does the power and influence secured by business leaders react upon other groups in the community—socially and politically as well as economically? During a long period, particularly in the last century and a half, the businessman has helped to shape his social and political as well as his economic environment. His social and political influence has arisen out of his economic power. Nowhere has this been more true than in England and the United States. But while businessmen in general (but by no means always) have been willing to accept a large share of the responsibility for efficient business leadership, they have not, for the most part, been willing to accept the broad social and political responsibilities that were attached to that leadership.

[11] Chap. 2 makes some attempt to evaluate the present importance of the large corporation in the United States.

to be included in the leadership function, whom do we find actually performing this role among the lower and higher ranking executives, directors, large and small stockholders, bankers, and such other groups as may exercise some influence over the large corporation's affairs? How effective is our present system of corporate business leadership, with its elaborate division of labor and delegation of responsibility, in directing the giant impersonalized undertakings which make up large-scale industry?

Strangely enough, we have little information on the manner in which the leadership function is actually performed in the very large firm. It is true that the economist has for decades freely used the concept of entrepreneur and of business leader in discussing many types of economic problems—for example, the determination of prices, the nature and causes of cyclical fluctuations, and so on. And many pages have been covered with economists' ponderings as to the nature of that peculiar income we call business profits. But to most economists, even today, the "entrepreneur" still means only the owner-manager, usually, by implication, of a small manufacturing business. For the most part, as we have seen, this sort of entrepreneur is made to operate in a highly competitive world, within which he reacts mechanically and automatically to underlying market forces.[12] Some brief consideration has been given to the question of who is the "entrepreneur" in the corporation, but this has not been preceded

[12] This sort of automatic and predetermined behavior is generally assumed even in present-day discussions of monopolistic competition (excluding the case of oligopoly). When, as in recent writings on non-competitive price determination and the effect of business expectations on cyclical fluctuations, the entrepreneur is given a more active and independent role, he still remains for the most part the owner-manager exercising a relatively simple and undivided function of decision-making, to which the bearing of business risks is usually added. In the field of price analysis, a few writers have attempted a more realistic approach to the problem of entrepreneurial decision-making. See, for example, the articles by Nourse, Mason, and Burns previously cited (p. 8 *n.* 8); E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress* (1938); E. G. Nourse, *Price Making in a Democracy* (1944); and Walton Hamilton and Associates, *Price and Price Policies* (1938).

by the necessary study of the manner in which business leadership is actually carried on in giant concerns characterized by a separation of ownership and management, and in which control and responsibility are delegated and shared in a number of ways.[13]

Businessmen themselves, and those who write about purely business subjects, have of course given considerable thought to some of the problems of leadership created by the large corporation. There is, for example, a rapidly growing literature on "management problems." A great deal of this literature is concerned with matters of organization, principles of "scientific management," suggestions for handling particular types of business problems faced by management in both the upper and lower ranks, and similar technical questions. Here again, however, there has been almost no systematic attempt to determine, for any wide range of large-scale industry, how the leadership function is actually performed,[14] and with what effects on the operation of the economic system. Despite the mounting literature on corporate management, we still know surprisingly little about how and by whom, in the large corporation, prices are set, investment decisions are made, key executives and directors are chosen, and so on. The questions that we posed earlier in this chapter concerning the nature and method of performance of the leadership function in the large corporation remain for the most part unanswered.

[13] An important start was made by Adolph A. Berle and Gardiner C. Means in *The Modern Corporation and Private Property* (1932), although this study was not specifically directed toward determining in detail how and by whom important decisions are made in the large corporation.

[14] A partial exception is Paul E. Holden and others, *Top-Management Organization and Control* (1941).

CHAPTER II

THE PRESENT CORPORATE SETTING FOR BUSINESS LEADERSHIP

Since we are concerned with business leadership in the *large* corporation, two questions suggest themselves: (1) How important is the large corporation in present-day American economic activity? (2) What special conditions does the large corporation create for the exercise of business leadership?

THE PREVALENCE OF THE CORPORATE FORM

The business corporation has come to dominate most fields of economic activity in the United States. Among the twelve groups of activities listed in the table on page 14, in only three (agriculture, service, and miscellaneous) do unincorporated enterprises perform the major part of the business done. These three industrial groups accounted for 25 per cent of the national income produced in 1937. In six industries, originating about 45 per cent of the 1937 national income, corporations accounted for 80 per cent or more of the business done. In the important manufacturing group, which alone accounts for about one fourth of the national income, 92 per cent of the business was done by corporations. Taking all these industrial groups together, it has been estimated that, very roughly, something like 60 to 65 per cent of the total volume of business in the United States in 1937 was performed by corporations.[1]

These figures on the importance of corporate activity should be taken as rough approximations only, subject to an indeterminate margin of error. They can be used, however, as indi-

[1] Estimate of W. L. Thorp, in *Investigation of Concentration of Economic Power*, Hearings before the Temporary National Economic Committee, Pt. I, 75 Cong. 3 sess., p. 97. (These hearings will hereafter be referred to as TNEC Hearings.) This estimate is little changed if government activity is excluded.

cating the general order of magnitudes involved. We can safely conclude that, at least in terms of volume of business, the corporation is much the most important form of business organization in this country. Individual proprietorships, however, still far outnumber corporations, and to the former must also be added partnerships and other forms of unincorporated enterprises. Even if we exclude farms and the professions, corporations probably do not account for more than a fifth to a fourth of the total number of business firms in the United States.[2] But practically all moderately large concerns take the

IMPORTANCE OF CORPORATE ACTIVITY, BY BRANCHES OF INDUSTRY[a]

Industry	Percentage of National Income in 1937[b]	Percentage of Business Done by Corporations, Various Years, 1929–37
Agriculture	8.9	7
Mining	2.1	96
Electric light and power and manufactured gas	1.6	100
Manufacturing	24.0	92
Contract construction	2.1	60[c]
Transportation	7.3	89
Communication	1.3	100
Trade	12.5	58
Finance	9.3	84
Government—*including work relief wages*	13.5	58
Service	11.9	30
Miscellaneous	4.2	33

[a] With one exception, the figures in this table were taken from *Investigation of Concentration of Economic Power*, Hearings before the Temporary National Economic Committee, Pt. I, 75 Cong. 3 sess., p. 96. The exception is noted in footnote [c]. For the meaning of "business done" and a general discussion of the estimates given in this table, see App. A.

[b] The figures in this column indicate the fraction of total national income produced which was contributed by each of the industries mentioned. These percentages do not total 100 because of the omission of social security contributions by employers. See U. S. Bureau of Foreign and Domestic Commerce, *Income in the United States, 1929–37*, Table 2.

[c] The estimate given in the source cited for the percentage of construction business done by corporations (36 per cent) was rejected as inaccurate. The figure here used is taken from National Resources Committee, *The Structure of the American Economy*, Pt. I, (1939) p. 375. Reasons for rejecting the TNEC estimate are given in App. A.

[2] Accurate data on the total number of business firms in the United States are not available. A total of 478,857 active corporations filed income tax returns for 1936. Making a rough guess, I would place the total number

corporate form, and without exception all of our very largest private business undertakings are corporations. Thus while in a sense incorporation is not a typical characteristic of American business firms in general, incorporated enterprises own the bulk of business assets and handle the major part of the business done. In only a few fields, notably agriculture, does the corporation play a relatively minor role.[3]

THE IMPORTANCE OF THE LARGE CORPORATION

There is no single answer to the question: How important is the large corporation? It depends on one's interpretation of the words "large" and "important."[4] We shall go only far enough in our statistical presentation to permit the reader to draw his own conclusions as to how important a segment of American business (important according to any one of several criteria) is controlled by corporations large enough to present the sort of leadership problems that we shall investigate in later chapters.

The table on page 17 presents some of the material necessary for a study of corporate size. The percentages in this table indicate, for each major industrial grouping and for all groups combined, the distribution of the assets of corporations submitting balance sheets with their tax returns in 1933 according to size of company (in terms of total assets).[5] Thus,

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of business firms in the United States in 1936, excluding agriculture and the professions, at something over 2 millions. For partial supporting evidence, see National Resources Committee, *The Structure of the American Economy*, Pt. 1 (1939), pp. 99, 384-85; U. S. Bureau of Internal Revenue, *Statistics of Income, 1936*, Pt. 2, p. 46; and TNEC Hearings, Pt. 1, p. 227.

[3] For further evidence on the prevalence of the corporate form, see Twentieth Century Fund, *Big Business, Its Growth and Its Place* (1937), pp. 11-20, and L. S. Lyon and others, *Government and Economic Life*, Vol. 1 (1939), pp. 493-97.

[4] See, for example, the conflicting answers to this question cited by E. B. George, "How Big Is Big Business?" *Dun's Review*, March 1939. A good part of the literature on the subject is cited in this article; other references will be found in the footnotes on later pages of the present chapter.

[5] Although later information is available, data for 1933 had to be used. After that year, companies were not permitted to file consolidated returns, even though subsidiaries were wholly owned by the parent companies. (An exception was made for railroads. For companies filing on a fiscal year

referring to the column marked "all corporations," we see that corporations with assets under $50,000 each in 1933 owned only 1.4 per cent of the total assets reported by all corporations submitting balance sheets in that year. Companies with assets of 50 millions or more, on the other hand, owned 53.3 per cent of the total assets reported by all companies. The other columns in the table, covering the major industrial groups, are to be interpreted in similar fashion.[6]

Not all corporations submitted balance sheets with their tax returns. Those which did not were mainly small concerns. An estimate was made of the probable assets of these firms and new percentages were computed to show the proportions which the assets of the "giant" corporations (assets of 50 million dollars or more) bore to the assets of all corporations.[7] These percentages are shown in parentheses, opposite the 50-million size-group, in the table on p. 17. Since the assumption was made that corporations not filing balance sheets all had assets of less than 50 million dollars, the effect of the adjustment was to reduce slightly the figures for the percentages of assets held by the largest corporations.

It is clear that a substantial fraction of total corporate wealth has come under the control of a relatively few very

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basis, the prohibition became effective at the end of 1934.) As a result, figures for later years understate the fraction of all corporate assets held by the largest corporations. For example, the proportion of the total assets of all manufacturing corporations reported by concerns with assets of 50 millions or more dropped from 46.2 per cent in 1932 and 45.8 per cent in 1933 to 37.3 per cent in 1934. This decline was largely attributable to the withdrawal of the privilege of filing consolidated returns. (See W. L. Crum, *Corporate Size and Earning Power* (1939), pp. 39-43, 152-53.) Some understatement of the assets of large firms is involved even for 1933 and earlier years. Consolidation of subsidiaries was permitted only when 95 per cent ownership was involved; even in these cases consolidation was merely permitted, not made obligatory; and in 1932 and 1933 a small penalty tax was imposed on companies filing consolidated returns.

[6] The table on p. 17 gives the distribution of assets by size of company. Distribution of the *number* of corporations by size of company shows of course a much different picture. For example, the smallest companies (assets under $50,000) controlled only 1.4 per cent of total assets of all corporations, but they accounted for 54.4 per cent of the total number of corporations submitting balance sheets in 1933. See U. S. Bureau of Internal Revenue, *Statistics of Income*, 1933, pp. 166-67, 172-89.

[7] For the method of making this adjustment, see App. A.

PERCENTAGE DISTRIBUTION OF CORPORATE ASSETS ACCORDING TO SIZE OF COMPANY, FOR ALL CORPORATIONS AND EACH MAJOR INDUSTRIAL GROUP, 1933[a]

Size Group (In thousands of dollars)	All Corporations	All Non-Financial Corporations	Agriculture	Mining and Quarrying	Manufacturing	Construction	Transportation—Public Utilities	Trade	Service	Finance	Miscellaneous
Under 50	1.4	1.9	3.7	0.9	1.4	8.7	0.3	9.5	4.6	0.7	6.6
50– 250	4.9	5.2	16.5	4.3	5.0	19.5	0.6	20.1	12.3	4.3	23.5
250– 1,000	7.8	7.2	25.2	9.2	8.8	21.2	1.1	18.5	18.2	8.7	30.1
1,000– 5,000	12.2	10.5		18.6	13.9	21.6	2.5	16.8	27.1	14.9	39.8[c]
5,000–10,000	6.0	5.4	54.6[c]	10.5	7.0	6.7	2.5	6.6	9.1	7.2	
10,000–50,000	14.4	13.6		56.5[c]	18.1	22.3[c]	9.2	11.9	28.7[c]	15.6	—
50,000 and over	53.3	56.2			45.8		83.8	16.6		48.6	—
50,000 and over, adjusted[b]	(51 0)	(54.5)			(45.4)		(79.8)	(16.2)		(45.8)	

[a] Compiled from U. S. Bureau of Internal Revenue, *Statistics of Income*, 1933, pp. 166–67 and 172–89. "All corporations" means all corporations submitting balance sheets with their tax returns. See text, p. 15.

[b] The percentages in parentheses indicate the proportions of the total estimated assets of all corporations, ***including those not submitting balance sheets***, which were accounted for by corporations in the largest size group. See text, p. 16, and App. A.

[c] These classes are grouped to conceal data and the identity of the few corporations reporting in one or more of these size classes. The Twentieth Century Fund (*Big Business, Its Growth and Its Place*, pp. 60–61) has attempted to estimate the proportion of total assets, in each of the cases involving grouping of classes, which were probably held by the corporations with assets of 50 millions or more. Its estimates are, in percentages: agriculture, 9.7; mining and quarrying, 35.2; construction, 2.7; Service, 11.2.

large corporations. In 1933, 594 corporations each reported assets of 50 millions or more; of these, 375 were in non-financial fields. These 594 giants owned 53 per cent of the assets of all corporations, while the 375 non-financial giants held 56 per cent of the assets of all non-financial corporations.[8] If we include 10-million dollar concerns in our concept of "large corporation," some two thirds of the assets of all non-financial corporations belonged to the large companies.

The importance of the large corporation, however, varies tremendously among industries. The giant corporation is far more important in the field of transportation and other public utilities than in any of the other industrial groups. Since this field alone contributes something like a quarter of all corporate assets, the high degree of corporate concentration here strongly influences the over-all concentration ratios that we have cited. But this factor must not be overemphasized. In manufacturing, the 50-million dollar corporation accounted for about 45 per cent of the total corporate assets in that field, and the ratio is slightly larger in finance. The giant concern was also of considerable importance in mining and of moderate importance in trade. The 50-million dollar concern is practically non-existent in agriculture and relatively unimportant in construction and the service industries. If we take 10 millions in assets as our criterion of "large," from half to practically all of the corporate assets in manufacturing, mining, transportation and other public utilities, and finance were owned by large corporations; and a fifth to a third of total corporate assets in construction, trade, and service were controlled by corporations of at least this size.[9] While the tendency toward

[8] If allowance is made for corporations not submitting balance sheets, the figures are 51 per cent and 54.5 per cent, respectively. See Twentieth Century Fund, *Big Business, Its Growth and Its Place*, Chap. 4, for an analysis of the 1933 *Statistics of Income* data similar to that presented here.

[9] These percentages applying to particular industries must be interpreted with caution. A firm with activities in two or more fields is classed by the Treasury as belonging to the single industry in which the company is chiefly engaged. This crudeness in classification would be particularly important in the case of large corporations. The result may be either over- or understatement of the fraction of the total corporate assets engaged in a particular industry which is controlled by very large corporations. On the problems

bigness is by no means uniform, we can clearly conclude that a substantial fraction of corporate wealth—in some cases, the major part—has come under the control of a relatively few moderately large or very large corporations.

In addition to total assets, other criteria may be used in measuring the importance of the large corporation.[10] In general, the proportion of corporate wealth in the hands of these giant firms tends to be somewhat larger than their proportion of the total receipts or sales of all corporations and larger also than their fraction of the total labor force employed by all corporations.[11]

In what lines of activity were these giant corporations engaged? Of the 594 corporations listed by *Statistics of Income* as reporting total assets of 50 millions or more, 219 were engaged in financial activities. The distribution of the remaining 375 non-financial giants is indicated on page 20.

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involved in the industrial classification of the *Statistics of Income* data, see Crum, *Corporate Size and Earning Power*, pp. 34-39.

[10] Total assets include investments in the securities of other corporations and consequently involve some duplication. Approximate correction for this duplication can be made by subtracting the item "investments other than tax-exempt," which is made up primarily of holdings of corporate securities, from total assets. After this adjustment, the largest size-group controlled 49.9 per cent of the assets of all corporations, compared with about 53 per cent of total assets including intercorporate holdings. (Twentieth Century Fund, *Big Business, Its Growth and Its Place*, p. 63.) Although short-term intercorporate loans are not included in "investments other than tax-exempt," it is nevertheless undoubtedly true that this adjustment over-corrects for the duplication involved in intercorporate investments. First, some non-corporate investments are eliminated by this method. Second, though all intercorporate holdings should be eliminated from the total assets of all corporations, we should eliminate from the assets of the large companies only their holdings of each others' securities, not their investments in smaller companies (particularly if these investments are used to control other companies which have not been consolidated in the parent company's balance sheet).

If capital assets alone are taken as a criterion of importance, the proportion held by the 50-million dollar concerns rises to 55 per cent. (The same, pp. 65-66.) This figure in particular is dominated by the tremendous concentration in the transportation and public utility field. This field accounted for nearly half of the capital assets of all corporations, and in it the proportion of such assets held by the giant concerns amounted to 83 per cent.

[11] In 1933, the 375 giant non-financial corporations accounted for 31.8 per cent of the total compiled receipts of all non-financial corporations, including those not submitting balance sheets.

[12] See U. S. Bureau of Internal Revenue, *Statistics of Income*, 1933, pp. 172-89.

Agriculture	1	Transportation and other public utilities	207
Mining and quarrying	21	Trade	21
Manufacturing[13]	119	Service	5
Construction	1		

The great bulk of these large concerns is concentrated in transportation (that is, railroads), the non-transportation public utilities (gas, electric light and power, and communications), and manufacturing. Thus, it is chiefly in these fields that the "problem of the large corporation" arises, although, as we have seen, the moderately large company (particularly the firm with assets of 10 millions or more) plays a not inconsiderable role in other fields also.

THE 200 LARGEST NON-FINANCIAL CORPORATIONS

The 375 giant non-financial firms actually represented a somewhat smaller number of independent corporate units. A recent investigation indicates that 102 should be considered subsidiaries of the other 273 corporations with assets of 50 millions or more.[14] Other subsidiaries of these largest concerns are concealed in the smaller-size groups in the table on p. 17. Therefore the recent attempt of the National Resources Committee to evaluate the importance of the 200 largest non-financial corporations, after inclusion of all subsidiaries, commands particular attention.[15]

In the study of the National Resources Committee, an

[13] Of these manufacturing concerns, 93 were concentrated in three fields: food, chemicals (including oil refining), and metals. The remaining 26 were fairly evenly distributed among the other manufacturing groups listed in *Statistics of Income*. See the 1933 volume, pp. 174-84. See also Twentieth Century Fund, *Big Business, Its Growth and Its Place*, p. 55.

[14] National Resources Committee, *The Structure of the American Economy*, Pt. 1, p. 104.

[15] The same, Chap. 7 and Apps. 10-11. This work represents a continuation and improvement of the earlier analysis of the 200 largest non-financial corporations, applying to the year 1929, which was presented by Adolph A. Berle and Gardiner C. Means in *The Modern Corporation and Private Property*. The new analysis rests upon a special tabulation of the corporation tax returns for 1933. Access was had to the original returns, and hence it was possible to consolidate subsidiaries reporting on separate returns and to perform various computations which cannot be made from the published summaries in *Statistics of Income*. From this material the Committee compiled a list of the 200 largest non-financial concerns in 1933.

analysis was made of the assets and income-statement items of the 200 giants, and the totals were compared with the totals for all non-financial corporations to secure various concentration ratios or indexes of importance of the relatively few giant concerns. Some of the results are presented in the table above.[16]

Relative Importance of 200 Largest Non-Financial Corporations, 1933[a]

Assets or Receipts	Percentage of Assets or Receipts in Each Industrial Group Controlled by Largest Corporations in That Group[b]				
	200 Largest Non-Financial Corporations	78 Largest Manufacturing Corporations	48 Largest Transportation Corporations	48 Largest Public Utility Corporations	26 Largest "Other" Corporations
Total assets[c]	57.0	45.5	92.6	82.3	15.5
Total assets less taxable investments[d]	54.8	40.5	92.5	83.0	15.0
Capital assets plus inventories[e]	59.7	42.4	92.3	84.0	16.7
Capital assets[f]	64.2	45.8	92.5	83.8	17.8
Gross receipts from sales and services[g]	29.9	33.8	71.1	85.7	9.5

[a] Taken from National Resources Committee, *The Structure of the American Economy*, Pt. 1, App. 11, Tables II and III.

[b] That is, these percentages represent the proportion of the assets or receipts of all corporations in each industrial group which were controlled by those of the 200 largest corporations which belonged to that group. Thus, in the list of 200, there were 78 manufacturing companies, 48 transportation and 48 public utility corporations, and 26 companies in other fields.

[c] Involves some duplication.

[d] Involves only minor duplication but includes intangible assets.

[e] These percentages have been computed by the present writer from the absolute figures given in the source cited in footnote [a]. Capital assets include land, buildings, and equipment but exclude intangibles, and reserves for depreciation and depletion have been deducted.

[f] See footnote [e] for meaning of capital assets.

[g] Sum of gross sales where inventories are an income-determining factor and gross receipts from operations where inventories are not an income-determining factor.

[16] A full explanation of the material and methods used is given in National Resources Committee *The Structure of the American Economy*, Pt. 1, App. 11, and pp. 104-06. A similar analysis, also based on the original corporation tax returns, was carried through for 1929. In general, the analysis for 1929 confirmed the results previously obtained by Berle and Means. The study of the National Resources Committee, both for 1929 and 1933, represents a considerable improvement over the earlier Berle and Means study.

If we take assets as our measure of concentration, the proportion of corporate wealth held by the 200 largest non-financial corporations in 1933 ranged from 54.8 per cent to 64.2 per cent, depending on the particular asset figures used.[17] On the other hand, gross receipts give us a much lower index of concentration. Though the giant corporations controlled more than half of all non-financial corporate wealth, they accounted for only about 30 per cent of total gross receipts. Even this, however, is not an insignificant fraction.

Here again the over-all picture is strongly colored by the situation in the transportation and public utility industries. We can ignore the question, much debated by some writers, whether the high degree of concentration in public utilities and transportation does not stand on a peculiar footing—so that inclusion of these fields exaggerates the degree of control exercised by the giant concerns over the whole range of American industry.[18] From one point of view, this is certainly true, and we have indicated the relative importance of the large corporation in the other fields also. How "important" the giant corporation is in any "over-all" sense the reader can judge for himself. Transportation and public utilities on the one hand, and manufacturing on the other, account for 75 to 80 per cent of total assets of all non-financial

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Better and more complete information was available. As a result, the comparisons of the assets of the list of 200 with those of all corporations are based on much more comparable data than was true before, and additional types of comparisons can be made. In particular, the breakdown made by industrial groups enables us more precisely to evaluate the effect of the extreme concentration in the transportation and public utility industries on the over-all picture presented by all of the 200 largest concerns taken together.

[17] The word "controlled" rather than "owned" should be used in discussing the assets of the 200 largest. Not all subsidiaries were wholly owned, but the total assets of such subsidiaries were included. Majority ownership of the voting stock by another corporation was the criterion used in determining which companies were subsidiaries.

[18] See, for example, W. L. Crum, "On the Alleged Concentration of Economic Power," *American Economic Review*, Vol. 24 (1934), pp. 69-83.

corporations. If we should confine our study of business leadership to concerns as large as the 200 giants studied by the National Resources Committee, the results of the analysis would be applicable to a type of business organization which clearly dominates the corporate picture in these highly important fields. Even in other industries large corporations, though not necessarily in the giant class, play an important role. They present much the same leadership problems as the 200 largest corporations. The results of the analysis in subsequent chapters will have considerable relevance for some of these other industries also.

It must be emphasized that we have been concerned here only with *corporate* wealth and activity, not with total *business* wealth and activity. As we have seen, by no means all business takes the corporate form. Thus though more than half of all corporate wealth may be controlled by our 200 largest giants, certainly a considerably smaller fraction of total business wealth is so controlled. The report of the National Resources Committee previously cited suggests that the 200 largest non-financial corporations in 1933 controlled from 46 to 51 per cent of all industrial wealth (corporate and non-corporate but exclusive of agriculture).[19] This indicates at least the order of magnitude involved.

MANAGEMENT'S STAKE IN THE LARGE CORPORATION

Part of the new setting for business leadership created by the large corporation arises out of the diffusion of corporate ownership which has taken place, and out of the consequent separation of management and active business leadership from ownership. To an increasing degree, business leaders of our largest corporations have ceased to be important owners of the firms whose activities they direct. How this separation affects the exercise of the leadership function will be discussed in later chapters. In the remainder of this chapter, we shall

[19] *The Structure of the American Economy*, Pt. 1, pp. 105-06.

attempt to discover how far this separation of ownership and active leadership has gone.[20]

In another place, the writer has made a study of management stockholdings in one list of very large firms.[21] The sample studied included 155 companies, all those in Berle and Means' list of the 200 largest corporations in 1929 for which adequate stockholdings data were available for the year 1935. The results of that study indicated clearly that, for this group of companies, management typically owned but a very small fraction of the voting stock outstanding. The median percentage stockholding by total management in all 155 companies was less than 2 per cent.[22] For the 84 industrial companies in the sample, the typical (median) holding by management was 3.6 per cent of the outstanding voting stock. The typical management holding among 35 public utilities was only 1.18 per cent and was as low as 0.58 per cent among the 36 railroads in the sample. These figures are averages of the holdings of total management, that is, of all officers and directors combined. The averages for the holdings of executives alone or for non-officer directors taken separately were naturally much smaller.[23]

[20] We speak here of the separation of ownership and active leadership. Ordinarily the problem is stated in terms of a divorce between ownership and "control." This last word is badly overused, and it needs to be precisely defined to have significance in the present context. We are handicapped at this stage of the study by the fact that we have not yet considered in detail what groups in the corporation are likely to perform the leadership function. Our procedure in this section will be to study the ownership of officers and directors and then to ascertain the extent to which non-management stockholdings are sufficiently concentrated to permit through ownership the wielding of considerable power and influence (control?) over management by an individual, group, or another corporation.

[21] R. A. Gordon, "Ownership by Management and Control Groups in the Large Corporation," *Quarterly Journal of Economics*, Vol. 52 (1938), pp. 367-79. The nature of the sample and data used are fully described in this article.

[22] It was actually 1.74 per cent. That is, in half the companies management owned more and in half it owned less than this fraction of the outstanding voting stock. The arithmetic mean holding was 5.52 per cent. The median is a more reliable average than the arithmetic mean in this case, because the latter is given a strong upward bias by the existence of a few extreme items.

[23] See the table in Gordon, *Quarterly Journal of Economics*, Vol. 52, p. 371.

New and more reliable data, which have become available since this study was made, also emphasize the relatively small ownership by officers and directors in the very large firm. These data have been summarized in the table on page 27, which gives frequency distributions of the percentages of voting common stock outstanding held by officers, by non-officer directors, and by total management in 176 giant corporations at the end of September 1939. The 176 companies were selected from a list of the 200 largest non-financial corporations in 1937 compiled by the Securities and Exchange Commission for the Temporary National Economic Committee.[24] Twenty-four companies were eliminated from the list because they were subsidiaries of other corporations.[25] The remaining 176 giants each had assets of at least 60 million dollars in 1937. They include such closely held firms as the Ford Motor Company as well as companies whose securities are widely distributed among the public.[26] The figures in the table give the number of companies in which officers, directors, and total management owned specified percentages of the voting common stock outstanding.[27] Thus, to illustrate, in

[24] See TNEC, *The Distribution of Ownership in the 200 Largest Non-financial Corporations*, Monograph No. 29, prepared for the Temporary National Economic Committee by the staff of the Securities and Exchange Commission.

[25] The SEC included in its list of the 200 largest corporations any subsidiary of a company on the list, if the subsidiary had outstanding in the hands of the public, common and preferred stock (usually preferred) having a book value greater than the total assets of the smallest company included (about 60 million dollars). (See TNEC Monograph No. 29, pp. 3, 345.) Use of this criterion led to the inclusion of 21 companies a majority of whose stock was held by another corporation and of three railroads which were leased to and completely controlled by other roads. This procedure gives a bias to figures on stockholdings for all 200 companies. The bias is not serious in the case of management holdings. However, it is substantial when we study the concentration of ownership in the hands of large stockholders. The nature of the SEC sample is analyzed further in App. B below, where this list of the 200 largest non-financial corporations is compared with one prepared by the National Resources Committee for 1935.

[26] In the earlier analysis of management holdings prepared by the writer, the data then available permitted a study only of companies whose stock was listed on a stock exchange.

[27] It should be emphasized that the figures refer to voting common stock only. On the average, management's percentage holdings of non-voting

66 industrial companies officers owned less than 1 per cent of the outstanding voting common; in 29 companies, from 1 to 5 per cent; and so on.[28]

In 63 of the 176 companies (36 per cent), total management owned less than 1 per cent of the voting common stock. Holdings were less than 5 per cent in 120 companies. In only 16 companies did management own as much as 20 per cent. The median holding was 2.11 per cent.[29] Management owned considerably more voting stock in industrial companies than in the rails or utilities. Holdings of less than 1 per cent occurred *relatively* much more often among the public utility companies and the railroads than among the industrial companies. Of 36 management holdings of 10 per cent or more, 33 were in the industrial field. The median management holding for the industrial companies (3.49 per cent) was considerably larger than that for the public utilities

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common were greater than those of voting common stock; but the 200 companies in the original SEC list had outstanding only eight issues of non-voting, in contrast to 201 issues of voting, common stock. The market value of the non-voting common was only about 4.5 per cent of that of all common stock outstanding. (TNEC Monograph No. 29, pp. 57, 359.) Computations which cannot be presented here indicate that the averages obtained for voting common only are not greatly different from those that would have been obtained for all voting stock (common and preferred) and are somewhat lower than those based on all common stock or on all stock (common and preferred, voting and non-voting). In the writer's earlier study, all voting stock (common and preferred) was included.

[28] These data refer to beneficial ownership, including stock held indirectly through trusts, personal holding companies, and so on. Beneficial interest in an indirect holding was determined by the individual's right to participate in the income from the holding. On the whole, the SEC seems to have been very conservative in allocating stock to particular individuals when doubt existed. For further details, see TNEC Monograph No. 29, pp. 65-67.

[29] Management holdings totaled 4.8 per cent of the market value of all the voting common stock outstanding for the 176 companies. The existence of some relatively large holdings makes this figure (which, in effect, is a weighted arithmetic mean) higher than the median. In the writer's earlier study, the median management holding was found to be 1.74 per cent compared to a median of 2.11 per cent here. The difference, which is not large, is explained by the fact that the two studies do not make use of precisely the same basic material. The two lists of companies differ somewhat in composition (relatively more industrials and fewer railroads are included in the SEC list); the dates covered are nearly 4 years apart; and one study covered voting common only while the other included all voting issues.

Distribution of 176 Large Corporations According to the Proportion of Voting Common Stock Owned by Management, by Industrial Classes, September 30, 1939[a]

Percentage of Stock Outstanding	Number of Companies											
	All Officers				Non-Officer Directors				Total Management			
	Industrial	Public Utility	Railroad	Total	Industrial	Public Utility	Railroad	Total	Industrial	Public Utility	Railroad	Total
0– 1.......	66	33	21	120	44	28	14	86	23	27	13	63
1– 5.......	29	3	1	33	36	9	7	52	42	8	7	57
5–10.......	7	2	1	10	16	—	1	17	17	2	1	20
10–20.......	6	—	—	6	12	1	—	13	19	—	1	20
20–30.......	2	—	—	2	5	—	—	5	6	1	—	7
30–40.......	—	—	—	—	1	—	—	1	2	—	—	2
40–50.......	1	—	—	1	—	—	—	—	1	—	—	1
50 and over..	4	—	—	4	1	—	1	2	5	—	1	6
Total number of companies.	115	38	23	176	115	38	23	176	115	38	23	176
Median[b]..... Per cent	0.81	0.10	0.02	0.32	2.33	0.29	0.36	1.11	3.49	0.52	0.38	2.11

[a] This table was compiled from the data on holdings of individual officers and directors presented in TNEC Monograph No. 29 *The Distribution of Ownership in the 200 Largest Nonfinancial Corporations*, pp. 379–531. The industry classification and the class intervals are approximately the same as those used in the writer's earlier study of management holdings for a different group of companies; see *Quarterly Journal of Economics*, Vol. 52 (1938), p. 371. In compiling the present table from TNEC Monograph No. 29, data for 24 of the 200 companies listed were not used for reasons indicated on p. 25. See also App. B.

[b] Calculated from the original arrays.

(0.52 per cent) or that for the railroads (0.38 per cent).[30] The larger holdings among the industrials, however, are still but a very small fraction of the outstanding stock of the firms. In general, in all three fields, management ownership does not constitute even a substantial minority of the voting common stock issued by the giant concerns.

The ownership of officers and directors taken separately is of course smaller than that of the entire management group. The very small holdings of the executive group are particularly to be noted. The median holding for officers was less than 1 per cent even among industrial companies.[31] Directors' holdings, though small, were substantially larger than those of the executive group in each of the three industrial fields.[32] In the case of both officers and non-officer directors, average holdings among the industrial companies were substantially larger than those among the public utilities and railroads.

The particularly small ownership by management in public utility and railroad enterprises is not surprising. In both fields, there is less opportunity for entrepreneurial initiative than in most industrial companies; there has been a marked tendency toward professionalization of management; and participation of the public in ownership is widespread. Professionalization of management has gone further in the rails and utilities than among the large industrials, although it is becoming increasingly important in the latter, also.

[30] The corresponding medians for total management holdings in the writer's earlier study were: industrials, 3.60 per cent; public utilities, 1.18 per cent; railroads, 0.58 per cent.

[31] The median holding for industrial officers in the earlier study was 1.38 per cent, compared to 0.81 per cent in the present case.

[32] The median directors' holding among industrial companies, 2.33 per cent, is substantially larger than that obtained in the earlier study (1.01 per cent). This is perhaps the most significant difference in the results of the two studies, which otherwise agree fairly closely. The fact that the later SEC data give a substantially higher figure for directors' holdings in industrial companies may arise, at least in part, from the inclusion of a number of fairly closely held companies which were not covered in the writer's earlier study. While the relative discrepancy in this case is substantial, even the later more comprehensive data give a median holding for directors of industrial companies of only 2.33 per cent.

The way in which widespread public ownership is related to the particularly small management holdings in the railroad and utility fields is rather complex. Intercorporate stockholdings and the building up of loose "systems" are more prevalent among the rails and utilities than among the industrials; this intercorporate ownership reduces the amount of stock which can be held by the general public. On the other hand, the prevalence of intercorporate holdings among rails and utilities has led to considerable concentration of control in the hands of those directing the affairs of the stockholding companies;[33] the concentration of ownership in the hands of other corporations reduces the possibility that the managements of particular utilities or railroads can become large stockholders; and the existence of this concentrated control and ownership in the hands of outside groups almost certainly lessens the desire of the managements of companies so owned and influenced to acquire stock in their own concerns.[34]

As we should expect, the separation of management and ownership is more marked among very large corporations than among smaller concerns. In an earlier study of 107 small and large industrial companies, some having assets of as little as one million dollars, the median stock ownership for total

[33] The table on pp. 40-41 below, is illuminating in this connection. In only 3 out of 93 manufacturing companies, in the list of 176 giants, does the SEC list the dominant stockholding group as being one or more other corporations. In 8 out of 23 railroads, however, the dominant stockholding group is reported to be one or more other firms. The most striking situation occurs in the public utilities. (The SEC excluded communications and transit companies from this category in the tabulation on pp. 40-41.) Here the dominant stockholding group was one or more other corporations in 20 out of 32 cases. Of course, these extensive intercorporate holdings in the public utility field are in the process of being greatly diminished as the SEC carries out the "death sentence" provisions of the Public Utility Holding Company Act.

[34] Certain other factors not mentioned in the text may tend to make management holdings in the industrial companies larger. Arrangements for the distribution of stock among officers (through the issuance of purchase warrants, bonuses in stock, and so on) are more common among industrial companies. The relative attractiveness of securities in the three fields as investment and speculative media is another point which should not be neglected. This factor by itself would probably tend to produce the smallest management holdings in the railroads, the largest in the industrials.

management (officers and directors together) was found to be 8.1 per cent.[35] This compares with a median of 3.5 per cent for management stockholdings in the industrial companies included in the list of 176 giants.[36] The fact that the median in one case was more than twice that in the other is largely explained by the difference in average size of the companies in the two groups. In the sample of 107 large and small industrials, management ownership averaged well above 10 per cent in companies with assets of less than 50 millions (around 20 per cent for companies with assets under 10 millions). Management holdings fell below 10 per cent for companies with assets of more than 50 millions and below 5 per cent for companies with assets of 250 millions or more.[37]

OWNERSHIP BY "CONTROL" GROUPS

Thus far we have been discussing only management stockholdings. But what of the holdings of non-management groups, individuals or other corporations, which may exercise some part of the function of active leadership or otherwise influence management?

Factual evidence on the diffusion or concentration of corporate ownership has been relatively scanty. Such evidence as was available until recently suggested that among very large firms the proportion of ownership represented by stock-

[35] This study, also by the author, appeared in 1936. See "Stockholdings of Officers and Directors in American Industrial Corporations," *Quarterly Journal of Economics*, Vol. 50 (1936), pp. 622-57. The 107 companies comprise a partly random, partly representative sample of industrial companies listed on the New York Stock Exchange in 1935. The date to which the stockholdings figures apply is July 1, 1935, and the management ownership figures refer only to common stock.

[36] And of 3.6 per cent in the writer's other study of 155 giant corporations. These various percentages do not all refer to the same kinds of stock. The study of 107 industrials dealt wth voting common stock only, as do the SEC data analyzed earlier in this section. The writer's study of 155 giants, however, covered all voting stock.

[37] See Gordon, *Quarterly Journal of Economics*, Vol. 50 (1936), p. 638. For other data bearing on the inverse relationship between size of company and management's proportionate stockholdings, see Gordon, *Quarterly Journal of Economics*, Vol. 52 (1938), pp. 377-79, and TNEC Monograph No. 29, pp. 58, 363.

holdings large enough to give their owners a substantial measure of power over management was, on the average, fairly small.[38] A wealth of new information bearing on the concentration of ownership in the large corporation has recently been compiled by the SEC and made available in a TNEC monograph.[39] These data permit us, for the first time, to determine with some precision the magnitude of the largest holdings in each of a wide group of giant corporations—the same companies for which management stockholdings were analyzed in the preceding pages.[40] The new material suggests that the concentration of ownership in the giant corporation is somewhat greater than has been ordinarily assumed.

The table on page 32 indicates the extent to which ownership of the group of 176 giant concerns was concentrated in the hands of the 20 largest stockholders of record at about the end of 1937.[41] Only common stock is considered,[42] and the data refer to stock issues rather than to companies.[43] The

[38] Compare Berle and Means, *The Modern Corporation and Private Property*, Bk. 1, Chap. 5; Gordon, *Quarterly Journal of Economics*, Vol. 52 (1938), pp. 390 ff.

[39] Monograph No. 29, which has already been extensively cited in earlier pages of this chapter.

[40] The beneficial holdings of the 20 largest stockholders in each of the 200 largest corporations are listed in App. 10 of Monograph 29. The material presented there covers more than 800 pages. Summary tables based on this information are presented in App. 9 of the monograph, Chap. 5 of which summarizes and interprets the data. Chap. 6 and App. 11 present further valuable material on stockholding interest groups in the 200 largest corporations.

[41] While most of the stockholdings data refer to the end of 1937, some of the material collected by the SEC refers to later dates between 1938 and 1940. See TNEC Monograph No. 29, pp. 51 and 70.

[42] Inclusion of preferred stocks would not have changed the results materially. For all 200 companies covered by the SEC, the 20 largest holders owned about the same fractions of both preferred and common. In some of the industries, however, the fraction of preferred stock owned did differ substantially from that for common stock. See TNEC Monograph No. 29, pp. 70, 72, 73.

[43] To save time and expense, I have used, in this analysis of the 20 largest holdings, summary tabulations already prepared by the SEC and have not prepared new tables directly from the raw data for individual companies. Since the SEC tabulations are in terms of issues rather than companies, the

DISTRIBUTION OF 183 COMMON STOCK ISSUES OF 176 LARGE CORPORATIONS ACCORDING TO THE PROPORTION OF THE ISSUE OWNED BY THE 20 LARGEST RECORD STOCKHOLDERS, 1937–39[a]

Percentage of Stock Outstanding	Number of Issues				
	Manu-facturing	Rail-roads	Electric, Gas, and Water	Other[b]	All Companies
0– 5........	11	5	—	3	19
5–10........	15	4	3	5	27
10–20........	27	3	4	2	36
20–30........	14	—	8	8	30
30–40........	9	4	4	3	20
40–50........	10	2	3	1	16
50–60........	4	1	5	1	11
60–70........	2	1	2	1	6
70–80........	2	2	—	—	4
80–90........	1	1	1	2	5
90 and over...	3	—	3	3	9
Total number of issues.	98	23	33	29	183
Median[c] (per cent)....	18.52	18.33	33.75	25.63	23.17

[a] Derived from TNEC Monograph No. 29, Table 97, pp. 609–10. The nature, method of treatment, and limitations of the data are described in the same, pp. 93–97. The figures are the frequencies given in this source, corrected to exclude 25 issues of the 24 companies which were considered to be subsidiaries of other companies. See p. 25, above. The data for the 25 issues excluded were secured from the information on individual companies in App. 10 of Monograph No. 29.

Not included in the ownership of the 20 largest holders are the holdings of banks and brokers for the account of unidentified beneficiaries. The source cited gives the figures both inclusive and exclusive of such unidentified holdings. We have used the data excluding them. The great majority of these holdings "reflected the holdings of a fairly large number of clients of banks and brokerage houses, with most of the individual holdings of small or moderate size." (The same, p. 72.)

The stockholdings data for about three fourths of the companies are as of about the end of 1937; the remaining are for various dates between then and early in 1940. See the same, p. 51.

[b] Includes chiefly extractive, merchandising, amusement, and communication companies.

[c] Medians were computed by the writer from the frequency series.

table shows how the 183 common stocks of the 176 companies were distributed according to the proportion of each issue owned by the 20 largest stockholders of record—exclu-

table presented here must necessarily take the same form. For the same reason, the industrial classification used in this and the next two tables differs from that used for management holdings.

sive, however, of banks and brokers holding stock for undisclosed beneficiaries.[44]

Referring to the last column of the table, we see that in only 19 cases did the 20 largest holders own as little as 5 per cent of the outstanding common. Twenty holdings accounted for 20 per cent or more of the outstanding stock in 101 cases, or more than half of the total number. In 35 cases, as few as 20 holdings totaled an actual majority of the outstanding common. The median was 23.2 per cent; that is, in exactly half the issues the 20 largest holders owned at least this proportion. For all 183 issues, the 20 largest holdings added to 23.8 per cent of the market value of the outstanding common.[45]

The concentration of ownership was greatest among the public utilities (excluding communications and transit companies), and substantially less among the railroads and manufacturing companies. The median percentage ownership of the 20 largest holders was nearly 34 for the utilities and between 15 and 20 for manufacturing and railroad companies.[46]

These figures suggest a fairly high degree of concentration in the ownership of the very large corporation. But it does not necessarily follow that the entire ownership of the 20 largest holders is associated with "control," however this word is defined. We need further information before we can determine how much ownership is associated with active leadership or with control defined in some other way. Let us, therefore, ascertain something concerning the nature of the persons, firms, or institutions owning the 20 largest

[44] It should be noted that several of the largest record holdings may belong to the same individual or group—and also that a given record holding, say that of a family holding company, may belong to two or more individuals.

[45] See pp. 34-35 below.

[46] The score of largest holders owned as much as 20 per cent of the outstanding common in 26 public utility issues (79 per cent of the total number), in 45 manufacturing issues (46 per cent), and in 11 or 48 per cent of the railroad issues. For the miscellaneous group, in 19 cases (66 per cent) as much as 20 per cent was owned by the score of largest owners.

holdings in our 176 giants. The following table indicates what fractions of the total market value of the common stock issues of these companies were owned by various types of stockholders represented among the 20 largest owners.

PROPORTION OF THE COMMON STOCK OF 176 LARGE CORPORATIONS OWNED BENEFICIALLY BY VARIOUS TYPES OF HOLDERS AMONG THE 20 LARGEST STOCKHOLDERS OF RECORD, 1937–39[a]

Type of Stockholder	Percentages of Market Value of All Common Stock				
	Manufacturing	Railroads	Electric, Gas, and Water	Other	All Companies
Individuals, personal holding companies, trusts, and estates[b]	17.7	1.9	4.3	9.6	14.2
Other corporations, non-financial[c]	2.9	12.7	18.0	0.9	4.5
Insurance and investment companies[d]	3.1	8.7	5.7	1.0	3.2
Banks and brokers as beneficial holders[d]	0.2	0.1	0.5	0.0	0.2
Foundations, etc.	1.2	0.2	1.2	0.7	1.1
Miscellaneous[e]	0.8	0.0	0.4	0.6	0.7
Total	25.8	23.7	30.0	12.8	23.8
Banks, brokers, etc.—beneficiaries not disclosed	5.0	5.8	5.0	3.5	4.8
Total, 20 largest record holders	30.8	29.5	35.0	16.3	28.6

[a] Derived from TNEC Monograph No. 29, Table 93, p. 601. The nature, method of treatment, and limitations of the data are described in the same, pp. 93–97. The figures given in this source have been adjusted to exclude 25 issues of 24 companies which were considered to be subsidiaries of other companies. See p. 25, above. The data for the 25 issues excluded were secured from information on individual companies in App. 10 of Monograph No. 29.

The stockholdings data for about three fourths of the companies are as of about the end of 1937; the remaining are for various dates between the end of 1937 and early 1940. Compare TNEC Monograph No. 29, p. 51.

[b] In the original source percentages are given separately for three groups: individuals, personal and family holding companies, and trusts and estates.

[c] This is a combination of two classes in the original source: parent and subsidiary corporations, and other non-financial corporations.

[d] This represents a combination of two separate classes as presented in the original source.

[e] This group includes governmental agencies and employees' welfare and similar plans.

For all 176 companies together, the 20 largest record holders owned 28.6 per cent of the market value of the outstanding common stock. However, nearly 5 per cent, about

one sixth of the total holdings, represented stock in the names of banks, brokers, and others which was being held for undisclosed beneficiaries whose number probably ran into the thousands. If we exclude these holdings, the fraction owned by the remaining 20 largest stockholders falls to 23.8 per cent.

For the entire group of companies, individuals and families—either through direct ownership or indirectly via personal and family holding companies, trusts, and estates—represented the most important type of stockholder. Total holdings of this group amounted to 14 per cent of the outstanding common. Other corporations owned 4.5 per cent, and insurance companies, investment trusts, and investment companies about 3 per cent. Holdings of the other groups were relatively small; the beneficial ownership of banks was negligible.

The various types of companies present several interesting contrasts. Large holdings by individuals[47] are far more important in the manufacturing field than among the other industrial groups.[48] About 18 per cent of the total value of the 98 manufacturing common stocks was owned directly or indirectly by individuals appearing in the list of 20 largest stockholders. Ownership by other corporations was apparently relatively small, on the average, among manufacturing companies. This is in contrast to the situation in the railroad and public utility industries, in both of which more than half the total identified holdings of the 20 largest owners belonged to other corporations, ordinarily to other companies in the same field. Between other corporations and insurance and investment companies, we can account for about 90 per cent of the 20 largest identified holdings in the case of the railroads and about 80 per cent in the case of the public utilities. In the miscellaneous group of companies, as in the manu-

[47] Including personal and family holding companies, trusts, and estates.

[48] The miscellaneous group conceals certain types of companies in which personal ownership is very important—for example, merchandising companies. See TNEC Monograph No. 29, p. 604.

facturing field, personal rather than corporate or institutional ownership accounts for the bulk of the 20 largest holdings.[49]

We are now in a slightly better position to discuss the extent to which ownership has been dissociated from "control." For the present purpose we may define "control" not as active leadership but as possession of the *power* to select or change management.[50] For ownership to carry this power, it must belong to a small compact group. For the control to be significant, the power should belong to a group capable and willing to use it when it is in its interest to do so. Insurance and investment companies, foundations, and certain other types of institutions are frequently not in a position to exert much power through ownership. They may give their proxies to some other stockholding group, but in this case the "control" of the latter is not measured merely by its own ownership. The significant ownership, from the point of view of leadership and control, is that of the first two classes listed in the table on page 34—individuals (including personal and family holding companies, trusts, and estates) and other non-financial corporations. These two types of holdings add to about 19 per cent of the total value of the common stock of the 176 companies.

The holdings of other corporations, which loom so large in the railroad and utility fields, require careful interpretation. The fact that 18 per cent of the common stock of the public utilities in our list of giant companies (13 per cent in the case of the railroads) is concentrated in the hands of a

[49] The miscellaneous group includes a hodge-podge of firms, chiefly extractive, merchandising, communication, and service companies. The inclusion of American Telephone and Telegraph has an important effect on the average percentage of stock owned by the 20 largest holders in this group. The percentage of A.T. and T. common owned by the 20 largest is relatively small, and, because of the great total value of the company's stock, this small percentage reduces substantially the percentage for all companies in the miscellaneous group.

[50] This is offered as a working definition by Berle and Means. See *The Modern Corporation and Private Property*, pp. 69-70. The SEC, in TNEC Monograph No. 29, pp. 99-100, defines control as "the power of determining the broad policies of guiding a corporation and not . . . the actual influence on the day-to-day affairs of an enterprise."

relatively few other corporations does imply a considerable degree of concentration of ownership. But in a very important sense, it is misleading to say that 18 per cent of the ownership of these companies is "associated with control." Let us assume that ownership of, say, 15 per cent of the common stock of a company is enough to give "control" to a stockholding group, in this case another corporation. The stockholding corporation is itself controlled by some group of individuals (directly or through yet other corporations). If the group controlling the stockholding corporation owns, say, 20 per cent of the stock of the latter, that group's proportionate ownership in the first company, 15 per cent of whose stock is held by the stockholding company, is only 3 per cent (.20 x 15 per cent). In short, large-scale intercorporate ownership is not an indication of an association of "control" and ownership—at least, ownership by those who do the controlling. It is rather a means of reducing the ownership needed for control by groups of individuals.

We come then to the conclusion that the substantial ownership of the 20 largest stockholders of record (28.6 per cent for all 183 issues) is not a good index of the extent to which ownership is associated with "control." The non-beneficial holdings of banks and brokers must be excluded. Further, some of the institutional owners included in the list of the 20 largest are not in a position to exercise much "control." Most important, the large corporate holdings, particularly in the public utility and railroad fields, are an inflated measure of the extent to which ownership is associated with "control." The most significant figure for measuring the association of ownership and control is the proportionate ownership, direct and indirect, of individuals or groups of individuals.[51]

By this index, a significant degree of ownership is associated

[51] This is not to imply that only such holdings should be considered (although in this writer's opinion, such a position is altogether tenable if individuals' holdings are made to include proportionate interests in all forms of indirect ownership). But they are more significant than the ownership of any other group or of any given number of largest stockholders (including institutional and corporate owners).

with control only in the manufacturing field and in the miscellaneous group.[52] In the manufacturing field, ownership by a relatively small group of very large individual stockholders is both frequent and substantial. In certain other types of companies concealed in the miscellaneous group, particularly in the merchandising companies, it is also substantial. In the railroad and public utility fields, however, ownership is not to any great degree associated with control by individuals, as distinct from control by other firms.

Naturally not all of the 14 per cent owned by the largest individual stockholders belongs in every case to the "controlling" stockholding group. An individual appearing in the list of 20 largest stockholders in a particular company may not belong to the family or group having the largest stockholding. In some cases, the largest individual stockholders may be unrelated and may not form a "control group" at all. On the other hand, the legal ownership of the dominant stockholders may be reinforced by their ability to vote the stock of other holders—foundations, for example, or other individuals or banks. And some of the holdings of the dominant group may be concealed among the holdings not included in the list of the 20 largest—for example, smaller holdings of relatives and friends.

The SEC, in the monograph which has supplied us with the data for the analysis of this section, has attempted to locate and to determine the ownership of the stockholding "control group" in each of these giant corporations. This type of analysis requires the use of more arbitrary judgment than was necessary in collecting the information we have thus far considered. It is by no means always clear whether particular stockholders belong to a given group. In the case of relatively small group holdings, say of less than 10 per cent, there is frequently doubt at to whether the stockholding group exercises enough influence for us to say that it wields

[52] If American Telephone and Telegraph is eliminated from the miscellaneous group, ownership by individuals jumps from about 10 to approximately 23 per cent.

any significant degree of "control." The analysis of the SEC, however, clearly represents much the most reliable and comprehensive information thus far available on the ownership of large stockholding groups.

The results of this study for the 176 giants we have been considering are given in the table on pages 40-41 which classifies the companies according to the nature of the stockholding group and also according to the size of the group's proportionate interest in the outstanding voting stock.[53] Thus, referring to the first column of the table, there were 28 manufacturing companies in which the dominant stockholding interest was a single family group; of these, 4 represented cases of majority ownership; and so on. As a further indication of the relative importance of the various types of "ownership control," we have indicated the fraction of the total assets of each industrial group belonging to the companies in all the types of control situation.

Of the 176 companies, the SEC found that a dominant stockholding group existed in 118, accounting for 56 per cent of total assets.[54] The interest groups consisted of one or more families in 77 companies, of a combination of families and other firms in 6 cases, and of one or more other firms in 35 instances. Majority ownership existed in 20 companies; of these, 9 represented holdings by a single family group. The dominant stockholding interest owned as much as 30 per cent of the voting stock in 58 companies, but only 22 of these cases represented a single family group, while 23 be-

[53] The method used by the SEC in identifying each stockholding "control group" is described in TNEC Monograph No. 29, pp. 99ff. See also, pp. 1488ff., where the ownership-control situation in each company is briefly indicated. Whether a given stockholding group was identified as a control group depended primarily upon the size of its ownership but also, particularly in the case of the smaller minority holdings, on the distribution of the remaining voting stock and on the group's representation in management (usually, apparently, on the board of directors).

[54] The SEC actually dealt with 200 companies, 24 of which we have excluded. For the entire group of 200 companies, the SEC classed 139 as being under "ownership control." See TNEC Monograph No. 29, pp. 1486-87, also p. 104.

Distribution of 176 Giant Corporations According to Type and Size of Dominant Stockholding Interest, 1937–39[a]

Type of Stockholding Group and Percentage of Voting Stock Owned[b]	Manufacturing		Railroads		Electric, Gas, and Water		Other		All Companies	
	Number of Companies	*Percentage of Total Assets*	Number of Companies	*Percentage of Total Assets*	Number of Companies	*Percentage of Total Assets*	Number of Companies	*Percentage of Total Assets*	Number of Companies	*Percentage of Total Assets*
I. Single family group										
50–100	4	*6.3*	—	—	2	*2.1*	3	*7.5*	9	*3.9*
30– 50	9	*8.9*	1	*0.8*	—	—	3	*4.5*	13	*4.2*
10– 30	10	*20.4*	—	—	1	*5.0*	2	*4.6*	13	*9.7*
Under 10[c]	5	*3.4*	—	—	2	*7.7*	1	*2.2*	8	*3.5*
Total	28	*39.0*	1	*0.8*	5	*14.8*	9	*18.7*	43	*21.3*
II. Two or more family groups										
50–100	3	*1.3*	1	*1.0*	1	*0.8*	1	*1.1*	6	*1.1*
30– 50	5	*2.9*	—	—	—	—	1	*1.0*	6	*1.3*
10– 30	11	*5.8*	1	*2.3*	2	*3.1*	3	*4.9*	17	*4.2*
Under 10[c]	4	*3.0*	—	—	—	—	1	*1.0*	5	*1.3*
Total	23	*13.1*	2	*3.3*	3	*3.9*	6	*8.1*	34	*7.8*
III. Family and corporate groups										
50–100	—	—	—	—	—	—	—	—	—	—
30– 50	1	*0.3*	—	—	—	—	—	—	1	*0.1*
10– 30	4	*4.3*	—	—	—	—	1	*0.9*	5	*1.8*
Under 10[c]	—	—	—	—	—	—	—	—	—	—
Total	5	*4.6*	—	—	—	—	1	*0.9*	6	*1.9*

IV. Single corporate group										
50–100[d]	—	—	—	—	—	—	—	—	—	—
30– 50	1	*5.1*	5	*14.2*	7	*27.2*	2	*2.6*	15	*12.5*
10– 30	—	—	—	—	5	*16.0*	1	*1.0*	6	*4.2*
Under 10[e]	—	—	—	—	—	—	—	—	—	—
Total	1	*5.1*	5	*14.2*	12	*43.2*	3	*3.6*	21	*16.7*
V. Two or more corporate groups										
50–100	—	—	2	*4.0*	3	*9.3*	—	—	5	*3.3*
30– 50	1	*0.4*	1	*0.9*	1	*1.9*	—	—	3	*0.8*
10– 30	1	*1.5*	—	—	4	*14.7*	1	*1.0*	6	*4.4*
Under 10[e]	—	—	—	—	—	—	—	—	—	—
Total	2	*1.9*	3	*4.9*	8	*25.9*	1	*1.0*	14	*8.5*
VI. No dominant stockholding group	34	*36.4*	12	*76.8*	4	*12.2*	8	*67.7*[e]	58	*43.8*
Total	93	*100.0*	23	*100.0*	32	*100.0*	28	*100.0*	176	*100.0*

[a] Derived from TNEC Monograph No. 29, pp. 1486–87. The figures in this source have been adjusted to exclude 24 companies which were considered to be subsidiaries of other corporations. See p. 25, above. The data for the 24 companies excluded were secured from the same source, pp. 1488 ff.

For about three fourths of the companies covered, the ownership situation refers to about the end of 1937; for the remainder, to various dates between then and early in 1940. See TNEC Monograph No. 29, p. 51.

[b] In the source cited, the various magnitudes of ownership interest are given not in percentages but as "majority ownership," "predominant minority ownership," "substantial minority ownership," and "small minority ownership." These categories are described as representing, respectively, the following percentage intervals: more than 50, 30–50, 10–30, and less than 10. (Monograph No. 29, p. 103.)

[c] Included here are only such stockholding interests of less than 10 per cent as are presumably associated with a considerable degree of control, as evidenced largely by representation of the stockholding group in management.

[d] I have excluded all cases of majority ownership by another corporation. The SEC places 22 of its 200 companies in this group. Twenty-one were among the 24 companies I excluded. A full majority of the voting stock of the twenty-second company, Electric Power and Light, was not owned by another corporation, and I have transferred this company to the 30–50 class interval.

[e] The size of this figure is due to the inclusion of American Telephone and Telegraph Company.

longed to one or more corporations and 12 to two or more family groups.

Of the 118 cases in which "control" through ownership was supposed to exist according to the data compiled by the SEC, more than half (60 in all) represented minority interests of less than 30 per cent. In 33 of these, the ownership was divided among two or more families or corporations. In other words, only 27 of the 60 holdings of less than 30 per cent belonged to a single family or corporation. Thirteen of the 60 companies represented holdings of less than 10 per cent; of these 13 holdings, 5 were divided among two or more families.

The SEC has interpreted the findings to mean that "control" through ownership (usually minority) is the typical situation in the giant corporation.[55] Even if we define "control" in a passive sense to mean the possession of the *power* to select management, not the exercise of active leadership, the interpretation is open to considerable question.[56] A number of the SEC's cases of "ownership control" represent ownership by another corporation—but control by some group of individuals who in turn "control" the latter, not necessarily through ownership. Of the cases of "ownership control" by family groups, a large number (34 out of 77) represent the combined holdings of two, three, or even more families. And nearly two thirds of the combined multi-family holdings total less than 30 per cent of the voting stock.[57]

[55] Thus: "In about 140 of the 200 corporations the blocks in the hands of one interest group were large enough to justify, together with other indications such as representation in the management, the classification of these companies as more or less definitely under ownership control." (TNEC Monograph No. 29, p. 104.) Control is defined as "the power of determining the broad policies guiding a corporation." The same, p. 99.

[56] It is even more open to question if we use the SEC's definition of control cited in the preceding footnote.

[57] Apparently in the majority of the cases of alleged multi-family ownership control with a stock interest of 30 per cent or less, at least 3 families were involved. Some of these (even when only two families were involved) are clear cases of "management control" as that phrase is ordinarily understood. For example, the Chrysler Corporation is listed as an example of multi-family ownership control (less than 10 per cent). The Bache family and

All of these instances indicate a high degree of concentration of ownership. But how many of them represent cases in which a single compact and unified group exercises "control" through the mere fact of its ownership? I should venture to say that probably in less than a third of the 176 companies does a small, compact group of individuals exercise "control" (actually possess the power to change the management) by virtue of the size of its own stockholdings. And the number of companies in which any large degree of *active* leadership is associated with considerable ownership is certainly even smaller.

While we may seriously question whether control through ownership is as prevalent as the SEC implied, it is clear that substantial minority holdings do exist in many of the companies—in somewhat more cases, probably, than has generally been assumed.[58]

W. P. Chrysler together owned only 3 or 4 per cent of the voting stock. Chrysler was then chairman of the board, and J. S. Bache was a director. "Control" was thus centered in the ownership interest. (See TNEC Monograph No. 29, p. 1496). This may be an extreme example of the SEC's method of treatment, but it does raise important questions concerning interpretation of its findings.

[58] Berle and Means classed 34 per cent of their 200 corporations as being controlled through ownership. (*The Modern Corporation and Private Property*, pp. 94, 115.) One important reason for the large difference between their findings and those of SEC lies in the contrasting treatment of intercorporate ownership. The SEC considered companies whose stock was held by another corporation as examples of ownership control. Berle and Means classified them according to the type of control situation existing in the stockholding company. Most such cases were considered as representing ultimate control either by management or through a legal device (pyramiding). Seventy-three companies were classed as under "immediate control" through minority ownership but only 46½ (some companies were classed according to two types of control situations) were considered to be ultimately controlled in this way. Sixty-five companies were classed as under immediate management control, 88½ under ultimate management control. The figures for control through legal device were: 21 for immediate control, 41 for ultimate control. (See the same, pp. 93-94, 115-16.) It is the figures on "ultimate control" that Berle and Means emphasized and which have been so widely cited.

If we take, in the SEC classification, the 35 companies in which a single family owned 10 per cent or more and the 12 firms in which two or more families owned as much as 30 per cent, we have 47 companies or only 27 per cent of the total. If we add the 17 cases of alleged multi-family control

We come now to the final and most important point in the analysis of the relations between ownership and "control." Even if we grant that in as many as 118 of the 176 companies a "control" group exists by virtue of substantial ownership, what does the control exercised by these groups mean? About this our tables tell us nothing. In most of the 118 cases the presumption is that, were a dispute with management to arise, the "controlling" group would possess the power to choose a new board of directors. This is merely a presumption. In some companies with strongly entrenched managements, it is doubtful whether the minority group, despite substantial ownership, actually has this power. More important, possession of this power does not necessarily mean that the stockholding group really selects either directors or executives or that it participates to any significant degree in the making of major decisions. Active leadership does not necessarily go with substantial ownership. "Control" in anything but a passive sense is not a function of the degree of ownership. How much active control or leadership any of the ownership groups actually exercise depends on a variety of circumstances and can be ascertained only by a careful analysis of the facts in each particular case. Such an analysis is attempted in Chapter VIII.[59]

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with 10-30 per cent ownership, we have 64 cases or 36 per cent. All 77 cases of single- or multiple-family control, including those with less than 10 per cent ownership, amount to about 44 per cent of the total number. Berle and Means classed 34 per cent of their companies as being under control through majority or minority ownership.

[59] It is unfortunate that the SEC was not more cautious and discriminating in interpreting the great mass of extremely useful data which it published in TNEC Monograph No. 29. In its present form, the SEC material is strewn with pitfalls for the unwary. For example, one very competent economist has recently accepted without question the SEC's statement that "about 140 of the 200 corporations" (including the 24 subsidiaries we have excluded) were "more or less definitely under ownership control." (See P. M. Sweezy, "The Illusion of the 'Managerial Revolution,'" *Science and Society*, Vol. 6 (1942), p. 5.) Our own investigation suggests that careful analysis of the SEC data does not support such a sweeping conclusion. The same writer also quotes approvingly the statement from *Fortune*, anent the SEC findings, that "it is clear that the idea of absentee ownership as usually interpreted is largely a fiction." (The same, p. 6.) We might add that, while

We conclude, then, that though substantial minority interests exist in a large number of the giant companies, the degree of ownership associated with control, even in a passive sense, is not as great as the SEC data suggest at first glance. Probably no more than a fifth, perhaps less, of the stock of the giant concerns is owned by those in a position to exercise a strong influence on management. Most important, however prevalent may be substantial minority holdings, the mere existence and size of these holdings tell us little or nothing concerning the extent to which stockholding groups actually participate in the function of business leadership. It is practically certain that those actively engaged in exercising the leadership function do not own, on the average, more than a small minority of the stock of the large corporations with which we are concerned. As we shall see in later chapters, corporation executives are today primarily responsible for the exercise of business leadership in the large corporation. To the extent that this is true, there can be no doubt that leadership and ownership are very largely in different hands.

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it is true that the diffusion of corporate ownership has probably not proceeded as far as is generally assumed, the SEC data themselves indicate that some 75 per cent of the common stock of the 176 giants is owned by others than the 20 largest stockholders (see the table on p. 34 above)—and we have indicated that by no means all of the remaining 25 per cent can be considered ownership that is associated with "control," in either an active or a passive sense.

CHAPTER III

BUSINESS LEADERSHIP IN PRACTICE

In Chapter I we described the function of business leadership in the abstract. That generalized description, however, is but a small first step in determining how the leadership function is actually performed amid the complexities that characterize modern business organization and practice. Even in the simplest type of business enterprise managed by an owner-entrepreneur, there is some question as to precisely what decisions and activities should be included in our concept of the leadership function and which excluded. The difficulties of analysis are far greater in the case of the large corporation. Here we run into a complicated diffusion of authority and responsibility within the enterprise. Stockholders, directors, and a hierarchy of executives are all in a position to share, in one way or another, in the exercise of business leadership. Where within these groups are we to find the real leaders in large-scale enterprise? The situation is worse confounded by the tangle of pulls and pressures exerted by groups outside the firm—bankers, organized labor, government, and so on. Is the power, influence, or "control" of these groups to be included in our concept of business leadership?

It is clear that we need to give greater concreteness to our concept of the leadership function before attempting to discover how and by whom business leadership is actually performed in the large corporation.

DIFFUSION OF AUTHORITY AND DECISION-MAKING IN THE LARGE CORPORATION

In the relatively small individual proprietorship, the owner-manager is clearly the business leader. He is the one whose decisions determine directly the course of his firm's operations, and his active leadership and the risk-taking inherent in

owning a business were the two standard elements traditionally attributed by economists to the entrepreneur. In the large corporation, however, these two elements have to be separated. Positive leadership is not generally performed by those who, through ownership, risk their property and receive profits. The situation is made even more complex by the fact that the leadership elements have become diffused among a hierarchy of salaried executives, directors, stockholders, and sometimes one or more outside groups.

Business leadership must be exercised in an economic system characterized by large corporate units as well as in a system in which small-scale business predominates. The fact that the legal owners (that is, holders of stock) have to a very large degree been eliminated from active leadership does not in any way obviate the necessity for the performance of the leadership function. In fact, the need for the function becomes greater the larger enterprises become. It is true, however, that when we attempt to apply the concept of business leadership to the large corporation, we encounter serious complications, and a concept that seemed clear-cut becomes vague and difficult of application. The chief problem arises from the fact that authority and responsibility in the large firm are divided among different men, and in a number of different ways.

In the large corporation, the following groups may participate, in varying ways, in business leadership:

1. Stockholders, who are nominally responsible for selecting directors, but who in practice may have no influence either in choosing them or in making any other important business decisions.

2. Various outside groups—bondholders, bankers, and so on—whose power may be great enough to give them a voice in selecting directors or otherwise influencing those responsible for decision-making.

3. The board of directors, which may be entirely passive, may select executives but otherwise make no decisions and

exercise no real veto power, or may regularly share with executives in making important decisions.

4. The top executives, who are chiefly responsible for the formulation of the more important decisions, the choice of subordinates, and the creation and maintenance of an adequate organization.

5. Minor executives, who administer the broad policies laid down at the top and, as a part of such administration, formulate decisions of a scope narrower than those handed down to them by the top executives.

Thus the function of business leadership becomes divided through a process of vertical division that we call "delegation." The process is further complicated by the horizontal division which takes place. On the same plane of authority the making of decisions may be shared by two or more persons, acting either as a group or in their individual capacities. For example, whatever decisions are made by the board of directors are likely to be made by two or more men, though not necessarily by the board as a whole. Further, though one executive may be formally the chief operating officer, major policies may actually be formulated jointly by himself and one or more other executives of prominence in the company. Similarly, many operating policies in large concerns are formulated today by committees rather than by single individuals. This horizontal division occurs again when policy formation is specialized at a given level of authority. Thus the president may make the important operating decisions; a committee of the board or the chairman of the finance committee may have control over major financial decisions. Neither can be considered subordinate to the other, though the board may view the financial decisions as being of greater importance than those affecting production or sales. At a lower level of authority we have "vice presidents in charge of" anything from production to public relations.

This complicated situation has been the despair of those economists who have considered at all the problem of leader-

ship in the large corporation. There is no general agreement as to how the function of business leadership should be defined or as to who performs this function in the large corporation.[1] We shall not concern ourselves with the problem of which words should be applied to which concepts. The indisputable fact is that business is still being led and controlled and that the co-ordination of production toward desired ends is still taking place. If business leadership has disappeared as a single unified function, we must nonetheless discover how the necessary business decisions are made in this complex situation.[2]

Our key to handling this problem will be to find out who in fact make the various decisions and policies which we include in the leadership function. We shall consider the men actually making these decisions as exercising some part of business leadership—regardless of whether higher up in the hierarchy of nominal authority there is some one else who *could* hire or fire this person or *could* make these decisions himself if he so chose. Business leadership consists, then, at least in part, of actually making certain broad decisions which determine the general nature of the firm's activities.

By "making decisions" we mean both *initiation* and *ap-*

[1] Economists have two problems in mind here: (1) risk-taking has been separated from leadership and (2) leadership itself has been divided. We are concerned here only with the second point.

[2] The "disintegration of the entrepreneurial function" caused by the delegation and diffusion of responsibility in the large firm has led some economists to treat the corporation as an "impersonalized" undertaking which in many respects runs itself. The corporation as an organization, it is said, has succeeded the old-fashioned entrepreneur. Thus A. R. Burns refers to "the contemporary practice of regarding the corporation as a not too seriously modified kind of entrepreneur." "The Organization of Industry and the Theory of Prices," *Journal of Political Economy*, Vol. 45 (1937), p. 666.

This point of view does not take us very far in attempting to evaluate the impact of new forms of leadership on the economic system. Until human activities settle down into a rigid and perfectly predictable pattern, active leadership will continue to be necessary in the large as well as in the small firm; and there will need to be individuals to provide this leadership. Leadership may be provided by a group rather than one individual and may be shared among a number of persons in many different ways. But this does not mean that the function of business leadership has disappeared. It has merely taken new forms.

proval. The man who sees the need for action and formulates a plan participates in decision-making as well as the one who approves and perhaps modifies the plan. It is true that many decisions may be initiated at a low level of authority. It is true also that discriminating approval of decisions from below by those at higher levels of authority involves a more responsible type of leadership than does mere initiation. A good case could be made for restricting our attention to active approval and for considering initiation as part of the decision-making process only in so far as the initiator has the power to approve his own decisions. Our reasons for including initiation are two-fold. First, we want to examine the entire process of decision-making in the large corporation, to see where decisions originate as well as where they are approved. Second, the larger the firm becomes, the greater the responsibility placed on those who initiate decisions and the more routine becomes the approval of those in higher authority.

In so far as business leadership means decision-making, then, it encompasses both initiation and approval. For us the point to be stressed is not whether initiation is or is not to be included. The important point is that we do not include the mere power to approve as part of the active leadership function. If the power to approve is not actively exercised, we do not consider that the person possessing that power participates in the leadership function. If the board of directors must approve dividend decisions but always and automatically follows the president's recommendations, we consider that the president, not the board, has exercised the final approval function. Possession of power alone does not constitute business leadership.

Naturally, we do not want to include in our concept of leadership any and all decision-making—that of the foreman as well as of the chief executive or of the board of directors. The most important decisions establish broad objectives for the business as a whole. From this highest level, decisions can

be ranged in a (very gradually) descending order of importance. We may speak of decisions being of high or low degree. Those of lower degree implement, or aid in administering, decisions of higher degree.

The decisions of the highest degree—those establishing broad objectives for the firm—are not the only ones which substantially affect the enterprise as a whole. Other decisions, lower in the scale but nonetheless important, affect the firm's activities to a significant extent and help to determine how the composite of economic resources controlled by the firm is to be directed toward productive ends. The making of such decisions should be included in the leadership function.

If we are interested in the functioning of the economic system, it is important that we know who in a particular firm determines the level of output, sets prices, decides when, to what extent, and on what terms new investment is to take place, and makes the other decisions upon which the allocation of resources and the volume of employment and output in the economic system depend. Our generalized definition of economic or business leadership requires that we include such decisions in the leadership function, regardless of whether the making of them represents merely delegated responsibility aimed at implementing higher-ranking decisions expressing broader aims or objectives.

These criteria are not as precise as we should like, but they provide working tools with which to examine the process of decision-making in the large firm. A fairly complete list of the kinds of decisions that we include in the leadership function is given in the next section of this chapter.

We have avoided the use of the word "policy" in this discussion of decision-making. Policy is a highly ambiguous term, meaning different things to different men.[8] To some, policies are what, in the preceding paragraphs, we called decisions of the highest degree, setting forth the aims and objectives of

[8] See, for example, C. I. Barnard, "Comments on the Job of the Executive," *Harvard Business Review*, Vol. 18 (1940), p. 296.

an organization.[4] To others, policies include also some lower-ranking decisions provided they set a guide or criterion for meeting future situations.[5] In the latter sense, policies are of varying degrees, the lower ones providing guides to action as a means of implementing the higher or broader policies.[6] As most commonly used by businessmen themselves, policy seems to mean any important decision, whether or not it sets a precedent or furnishes a guide for the future.[7] In view of these various meanings, it seems wise not to attempt to couch our definition of the leadership function in terms of "policy-making." When we use the term policy at all, we shall mean any decision which has a time dimension, that sets up a guide or criterion for future action. Whether particular policies in this sense are leadership decisions depends on the criteria of importance mentioned in earlier paragraphs.

Business leadership includes not only making important decisions of the sort described but also the choice of men who make and administer these decisions. Whenever the choice of any executive represents a decision which is capable of influencing to an important degree the activities of the firm as a whole, this act of selection should be included as part of the leadership function.

We come now to the final and perhaps most important element to be included in our concept of business leadership: *coordination,* or the creation and maintenance of organization.

[4] See, for example, Oliver Sheldon, "Policy and Policy-Making," *Harvard Business Review,* Vol. 4 (1925), pp. 1-6.

[5] Thus: "A business *policy* . . . is a general rule of action which is developed . . . for guiding members of an organization in deciding specific questions within the range of the policy as they arise under changing conditions." M. T. Copeland, "The Job of an Executive," *Harvard Business Review,* Vol. 18 (1940), p. 155. See also Paul E. Holden and others, *Top-Management Organization and Control,* p. 79.

[6] One corollary of this is that there is no very clear line between "policy-making" and "policy execution." This is true of both governmental and business policies. See C. J. Friedrich, "Public Policy and the Nature of Administrative Responsibility," in C. J. Friedrich and E. S. Mason, editors, *Public Policy* (1940), pp. 5-7.

[7] Yet another concept of "policy" is that associated with the use of the phrase "price policy." See E. G. Nourse, "The Meaning of 'Price Policy,'" *Quarterly Journal of Economics,* Vol. 55 (1941), pp. 175-209.

Co-ordination includes some decision-making: establishing broad objectives, initiating and approving changes in key personnel and in management organization, approving decisions on various matters in terms of the approver's interpretation of broad objectives, approving decisions on specific matters to avoid conflicts with other decisions. It also includes two other elements: the exercise of personal leadership and the mere *possession* of authority. The latter gives cohesion to and maintains organization, but it does not involve any particular form of action.

Co-ordination as a part of leadership exists wherever there is organization. The foreman, the mill superintendent, the sales manager, and many others in any large firm exercise a co-ordinating function. The co-ordination that is to be emphasized in a study of business leadership is the residual co-ordination that applies to the enterprise as a whole and must therefore be exercised at the apex of the organizational pyramid. By its very nature, this is not a function which can be delegated in the way that making specific decisions can be. Two or more men at the top may act as a group, but there must be some one co-ordinating authority (an individual or a small group).

In general, then, business leadership in the large firm includes initiation and approval of decisions affecting important economic variables which have a strong impact on the firm's activities (including choice of the men who make these decisions) and co-ordination or the creation and maintenance of organization. How much of what we have here called business leadership would be included in the usual definitions of "management" or "administration" or in many economists' definitions of the "entrepreneurial function" must be left for the reader to decide.

BUSINESS LEADERSHIP IN TERMS OF CONCRETE DECISIONS

Perhaps the preceding discussion can be made more concrete by mentioning the more important types of business decisions, the making of which should be included in the

leadership function. The following list is not complete but probably includes most of those types of decisions which are significant from our point of view. The list is in three parts, corresponding to the three stages in the life of the firm. These stages are (1) promotion and initial organization, (2) existence as a going concern, and (3) reorganization or liquidation.

I. Promotion and initial organization
   A. Determination of main objectives
   B. Setting up initial organization, involving:
      1. Decisions as to size, legal organization, financial structure, internal organization, specific products to be produced and methods of producing and distributing them, and so on
      2. Choice of key personnel
   C. Negotiation for the hire of the factors of production, particularly capital
II. Existence as a going concern
   A. Maintenance of organization through personal leadership and continuous exercise of authority
   B. Determination of the more important decisions relating to:
      1. Volume of output and control of production
      2. Prices
      3. Marketing (sales organization and methods, advertising, purchasing, and so on)
      4. Wages and other labor problems
      5. Financial problems, such as changes in capital structure, maintenance of working capital, securing new funds, and so on
      6. Changes in the size of the firm (expansion or contraction)
      7. Changes in the location of the firm or of important branches
      8. Changes in internal organization and procedures
      9. Changes in products and in (technical) methods of production

10. Relations of the firm with outside groups, either with specific groups, such as consumers, bankers, or government, or with the public in general (that is, "public relations")
11. Distribution of profits

C. Choice of the men who will make the above decisions and also of those primarily responsible for directing the execution of them

III. Reorganization or liquidation

A. Reorganization[8]
1. Decision to reorganize
2. Determination, for the transition from the old to the reorganized firm, of the matters listed under I

B. Liquidation
1. Decision to liquidate
2. Deciding the terms for the liquidation, primarily with respect to the distribution of assets

While this list is not complete, it should prove useful as a guide in the analysis of later chapters, in which we shall attempt to discover how and by whom, in large corporate organizations, these decisions are made.

The many functions listed may be performed by men at different levels of authority in the usual organization chart. Thus the chief executive officers (president or chairman of the board) may be responsible for the maintenance of organization and for financial policy; a vice president may make all important price or production decisions. Or a chief executive may share with one or more subordinates (for example, through committees) the making of various types of policies. Likewise, these fields of decision-making overlap. Thus decisions concerning expansion cannot be separated from the financial problem, which is also related, for example, to dividend policy. Price decisions are related to output and marketing decisions, and so on.

[8] Merger of a given firm with others can also be included under this heading by a slight elaboration of the outline.

This suggests that business leadership represents, as has already been pointed out, a good deal more than the making of decisions or policies on specific matters. Organizing the procedures of decision-making and co-ordinating the activities of separate decision-makers with reference to a common aim are even more important. In a sense, this job of organization and co-ordination (included in II-A, II-B-8, and II-C on our list and more generally encompassing a general supervision and final approval over all types of decisions) represents the very heart of the leadership function. The larger the firm and the more specialized and differentiated the kinds of decision-making, the more important becomes the co-ordinating aspect of the function of business leadership.

BUSINESS LEADERSHIP AND "CONTROL" BY INTEREST GROUPS

Every enterprise has to deal with a variety of "outside" interest groups. These outside groups may (and frequently do) seek to influence those directly responsible for business leadership in order to protect their own interests. When any of these groups—stockholders, bankers, competitors, and so on—are strong enough to influence directly those immediately responsible for policy, it is frequently said that they exercise some form of "control." It is in this connection that such phrases as "financial control," "ultimate control," "control by minority groups," and similar expressions are used. What relation does such control bear to the concept of active business leadership which we have developed in this chapter?

"Outsiders"—such as a banking group or a united minority stockholder interest—can acquire a great deal of power and be in a position to exert a very strong influence on those directly responsible for decision-making in any firm. While such groups possess power, however, they may or may not exercise some part of the leadership function. Power represents the ability to do something, not the actual doing. Thus a powerful interest group may be entirely passive, or may attempt actively to influence policy only on particular occasions. Ordinarily, the "control" of a strong interest group

resolves itself into two elements: (1) the ability to take effective action if at any time it thinks its interests are adversely affected, and (2) forming a part of the environment of which those actively responsible for policy must continually take cognizance. Neither of these elements by itself (nor the conjunction of the two) constitutes active leadership. As for the influence exerted by strong interest groups (the second element), this is a part of the environment within which the business leader operates, but it is not the decision-making and co-ordination which constitute the leadership function. True, the "influence" over the decision-maker shades imperceptibly into real participation in decision-making. But the two concepts —influence and active leadership—should be kept distinct.

The nature of the interest groups connected with the large corporation will be discussed in Chapter VII, and we shall examine at that point the conditions under which they often can acquire a substantial degree of power over the firm. For our present purpose, the important point is that our concept of business leadership does not include the power and influence of these outside groups—unless they really participate in the decision-making and co-ordination in terms of which we have defined the leadership function. The remainder of this study is devoted to discovering how the active function of business leadership is exercised and shared by those in management and by certain outside groups.

OUR METHOD OF ANALYSIS

In a system of delegated powers such as is found in the large corporation, an analysis of business leadership must deal with three related problems, two of them connected with the process of decision-making. First, where do important business decisions originate? The answer to this question leads us to the wellsprings of actual management. Second, what other persons, if any, veto or approve decisions? The answer here leads us to those finally responsible, in a real sense, for choosing among alternative lines of action.[9]

[9] Of course initiation and approval may be carried out by the same person, but this is not necessarily the case.

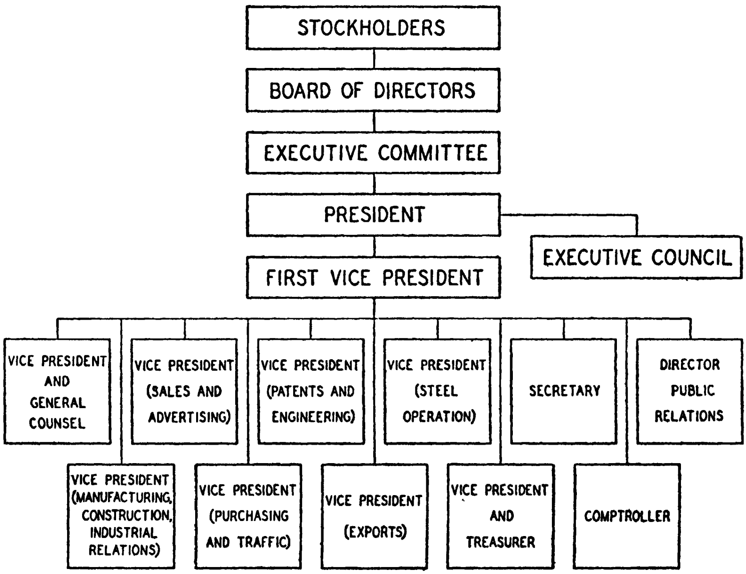
Finally, with whom is lodged the co-ordinating authority for the enterprise as a whole, and of what elements of leadership does this authority consist?

It is not easy to discover who make the various types of important decisions that we should include in the leadership function. Nominal powers granted by law (as to stockholders) mean little. By-laws and organization charts do not reveal a great deal more. Even analysis of the actual internal operations of a firm may leave the answer in doubt. Major operating decisions may be made by highly informal groups of executives over whose decisions the chief executive sometimes does and often does not exercise a veto, or for whom the latter acts as adviser or co-ordinator. A few key men on the board may "advise" the president on financial policy, approval of the president's subsequent recommendation being made automatically by the board as a whole at a later meeting. A trusted subordinate's suggestions may be tantamount to final decisions even though they must first go across the president's desk. The president may minutely consider recommendations concerning certain types of policy; others he may approve as a matter of course; yet others may be briefly considered as they fit into certain general policies. The board of directors and its standing committees may behave similarly with respect to matters laid before them. "Advice" and "opinions" of certain outside groups—particularly the ubiquitous banker—may be equivalent to orders to the board or the chief executive. In all such cases, who exercises business leadership?

The figure on page 59 is an actual organization chart recently prepared by a prominent company manufacturing certain types of machinery and equipment. The usual lines of authority and specialization are shown. But who initiates major decisions in this company, and which of the individuals or groups at the higher levels of authority actually exercise effective veto or approval over those initiating major decisions? Who is the final co-ordinator in this company, and

of what does such co-ordination consist? Further, what influence, if any, is exercised by various outside groups (bankers, customers, competitors, and so forth), which are not shown on the chart at all? No organization chart or list of assigned duties and powers can give us answers to these questions.

ORGANIZATION CHART OF MANAGEMENT IN A LARGE MANUFACTURING COMPANY



Difficult as it may be to ascertain the facts for a particular company, it is even more difficult to generalize about the situation prevailing in large-scale industry as a whole. No two companies handle their management problems in the same way, and in no two companies is the balance of power and authority, among the groups and individuals capable of making decisions, exactly the same. Differences in personalities, company history and background, products and processes involved, distribution of ownership, and numerous other factors give the stamp of individuality to the leadership situa-

tion prevailing in particular companies. These factors in any one company can change as time passes, and so can the identity of those exercising business leadership in that company.

Generalizations, though dangerous, are not impossible if they are carefully made and qualified. Such generalizations, however, to mean anything, must be painstakingly built on the foundation of careful and detailed case studies of individual companies. *A priori* statements can be only preliminary hypotheses to test against the complex and contrasting situations found in different large concerns.

The following eight chapters, comprising Part II of this volume, are based on a series of such case studies of the manner in which the composite function of business leadership is exercised in some of the largest American corporations. We shall try to ascertain what elements of business leadership are actually exercised by each of the putative leadership groups already mentioned—particularly executives, directors, stockholders, bankers, and government.

The companies chosen for study are very large; practically all had assets of at least 50 million dollars in 1935. They represent the so-called giant concerns discussed in Chapter II. Further, they are all companies with listed securities and considerable public ownership of these securities. No study has been made of the few large-scale corporate approximations to the individual proprietorship and partnership—for example, the Ford Motor Company or the Great Atlantic and Pacific Tea Company—or, for that matter, of any companies a majority of whose stock was owned by a single family or another corporation.[10] Since a good deal of reliance had to be placed on published material, the closely held corporation

[10] Of the 200 largest non-financial companies studied by the SEC, nine were listed as representing majority ownership by a single family interest group, and 22, majority ownership by another corporation. In addition, in six companies a majority of the stock was held by two or more family interest groups, and in five, by two or more corporate interest groups. See TNEC Monograph No. 29, *The Distribution of Ownership in the 200 Largest Nonfinancial Corporation*, pp. 1486-87. See also pp. 40-41 above.

largely defied analysis unless (as seldom occurred) information of the type sought happened to be available on the company. Even among companies with listed securities reporting to the SEC, adequate information was available for only a minority. In all, 65 of the 155 companies mentioned on page 24 were analyzed in detail.[11]

For the most part, information was collected on the leadership situation as it existed in the middle thirties. The year 1935 was taken as a reference date, but a good part of the material available referred to periods somewhat earlier or later than this.

It was possible to supplement published material with personal interviews in something less than half of the companies actually studied, and to these interviews were added conversations with government officials, experts in the field of management, bankers, and others who might throw some light on the situation in particular companies or on the problem in general.

Published material used was of many kinds, and of widely varying degrees of reliability. Among the more common sources of information were: investment manuals, reports to

[11] The 155 were those in Berle and Means' list of the 200 largest for which certain stockholdings data were available. Of the 155, 45 industrials, 10 public utilities, and 10 railroads were studied in detail. Case studies were also made of several other large companies, which do not appear in Berle and Means' original list. In addition, partial information on particular points was available for other companies. A list of companies cited is given in the index of companies at the end of this volume.

Choice of companies, as had already been implied, was dictated by the exigencies of available material. The sample was not chosen in advance so as to be a random or representative sample of large-scale industry. On the whole, however, the companies that were studied can be taken as a reasonably representative sample of the so-called giant concerns with listed securities. This is true with one important exception—emphasis has been deliberately placed on the "industrials," and the railroads and utilities form a smaller fraction of the sample studied than they do of, for example, Berle and Means' original list of 200 giants. Another modification in the representativeness of the sample is that not much attention was paid to companies in receivership at the time the study was made. The companies studied were very large, well established, and generally successful. It should be added that little consideration is given to extreme cases of mismanagement. The present study is concerned with the anatomy of business leadership and only incidentally with its pathology.

the SEC and other regulatory agencies, government reports, congressional hearings, court proceedings, company histories, biographies of particular men, articles in *Fortune* and other journals, newspaper items, and a variety of information supplied by the companies themselves—annual reports, by-laws, organization charts and instructions, executive orders, prospectuses, letters to stockholders, and so forth.[12] The most helpful material, of course, came from personal interviews with executives of the companies studied, though here, as in the published material, the point of view of the informant frequently gave a particular emphasis or coloring to the material supplied. Every attempt has been made to separate the wheat from the chaff in each case and to interpret the facts impartially, but the information is sometimes too meager or the situation too involved for this ideal always to be achieved.

Though a certain piquancy is thereby lost, companies and individuals will be identified by name only where the facts are generally known from published sources. This procedure permits a greater objectivity on the part of both author and reader and, in some cases, is necessary because of the terms

[12] The extensive use made in this study of such sources as *Fortune* and the *New York Times* perhaps requires specific defense. *Fortune* contains a mine of information on the subject matter of this book. It is not free of errors, but, in general, facts are reported accurately. By no means can the articles in the journal be considered as representing official company positions—or, at the other extreme—muckraking journalism. In view of the fact that statements in *Fortune* could frequently be checked, at least in part, in other sources, and in view of the final check secured through correspondence with the companies concerned, the writer felt free to use the journal with considerable confidence. As for the *New York Times*, the main items used represented stories based on press releases issued by various companies, were generally non-statistical in nature, and concerned events which were frequently reported in other newspapers, also. In view of the high reputation of the *Times* for both careful editing and comprehensive coverage of business and financial news, it was felt that this source could be used with confidence. The same could not be said for some of the other sources, such as official histories of companies, company magazines, trade papers, and so on. In all these cases, however, reporting of facts was generally accurate; it was usually interpretation of the facts that was in question. I have felt free to draw on such sources for facts about men and companies not elsewhere available but have been exceedingly cautious in relying on interpretations and opinions found in these sources, particularly wherever a controversial question was involved.

on which the material was made available for the purposes of the present study.

Relevant portions of the manuscript were submitted to each company about which major statements of fact were made. Whenever a company objected to a particular statement or interpretation, the facts were carefully rechecked. In this way, a number of errors in the original manuscript were eliminated. In several cases, however, the writer has not been able to agree with the interpretation of certain facts given to him by particular officials who objected to some of the references to their companies. In all such cases, it is the writer's, not the company's, version which appears in this study. Every attempt has been made to be objective and to state the facts as they appear to a careful observer who, while suffering under the disadvantage of being "on the outside," had the great advantage of being bound to no particular position or point of view.

PART II

BUSINESS LEADERSHIP BY MANAGEMENT AND OUTSIDE INTEREST GROUPS

CHAPTER IV

THE CHIEF EXECUTIVE AND THE DIFFUSION OF DECISION-MAKING

To most of us, the names of the chief executives of many of our largest corporations are at least vaguely familiar. We assume that these men "run" their companies—although most of us would probably be put to it to explain precisely how much of the "running" is done by these men at the very top and how much by their subordinates in the lower ranks.

This and the following chapter will deal with the leadership activities of not merely the chief executive but the entire executive group—from the president or chairman of the board at the top to minor functionaries in the lower strata of the executive hierarchy. Any or all of them may participate to some degree in the sort of decision-making which enters into our concept of business leadership.

THE CHIEF EXECUTIVE[1]

Within the executive hierarchy, the chief executive is, of course, the key individual. Ordinarily he bears the title *President* or *Chairman of the Board.* In a company which has no chairman, the president is almost invariably the chief executive.[2] Where there are both a president and a chairman, either may be the chief executive.

The division of labor between the chairman and president

[1] By "chief executive" we mean the official standing at the apex of the executive hierarchy, whatever his title may be. The chief executive has authority over all other officers and is himself responsible only to the board of directors. Which official is to have this position is ordinarily indicated in the company's by-laws.

[2] An interesting exception is provided by the recent history of the United Fruit Company. Between 1933 and 1938, Samuel Zemurray bore the title "Managing Director" but was undoubtedly the *de facto* chief executive. He was also the company's largest stockholder, and through his holdings and those of his friends he had forced a change in management in 1932. In 1938 he became president. See *Fortune,* March 1933, pp. 26ff.; *New York Times,* Feb. 1, 1938.

varies from company to company. Which stands out as the dominant individual and has the powers and responsibilities of the chief executive depends upon a number of circumstances.

Sometimes the chairman is a former president who has since retired and is no longer active. In such cases, the president is the top executive in fact, and the chairman plays a relatively passive role.[3] The latter may still serve as an adviser, but the active leadership role is played by the president.

Sometimes a president only partially retires when he becomes chairman of the board. In a number of cases in recent years, the president has relieved himself of some duties by becoming chairman but has retained the title of chief executive officer. Thus Alfred Sloan became chairman in General Motors in 1937; at the same time, the by-laws were altered to make the chairman the chief executive officer.[4] The same sort of change was made by General Wood in Sears Roebuck, and apparently by T. M. Girdler in Republic Steel.[5] In each case, the change marks the initial step in an active president's retirement. The immediate purpose is to relieve the new chairman of details and to assign a substantial degree of responsibility to the new president, who is eventually to be the chief executive. For several years after the change, the chairman may exercise nearly as much real leadership as he did as president. Sometimes, the president at first could more accurately be called an operating or executive vice president. Gradually, however, the chairman is likely to shift more and more responsibility to the president, and eventually he becomes relatively inactive. At some time during this gradual

[3] This was apparently the situation in Chrysler Corporation between the appointment of K. T. Keller as president in 1935 and Walter Chrysler's death in 1940. Charles Schwab of Bethlehem Steel seems to have been a relatively inactive chairman in his later years. In another company studied, the chairmanship was described as "a resting place for retired presidents."

[4] See *New York Times*, May 4, 1937, and the annual report of the company for 1937.

[5] *New York Times*, Jan. 29, 1939, and Apr. 15, 1937.

change, the president will have become in fact and perhaps also in title the chief executive officer.[6]

In some companies, the chairman is the chief executive officer and active head without first having been president. Thus Gary was chairman of the board and chief executive officer in United States Steel but never president. The same was true of Myron Taylor.[7] Between 1935 and 1940 Thorkald Rieber was chairman and chief executive officer of the Texas Corporation; before that, he had been a vice president. Floyd Carlisle, active chairman in Consolidated Edison Company of New York, had held no other office in this company.[8]

Sometimes the chairman's role, whether or not he is the chief executive, is a special one—to handle financial problems, public relations, or similar matters. This has apparently been the case in the General Electric Company,[9] and in recent years in the United States Steel Corporation.[10] A similar

[6] In American Sugar Refining Company, the president became chairman in 1925 but continued as chief executive officer. In 1937, although he continued as chairman, he relinquished the duties of chief executive officer, which were taken over by the president.

[7] Taylor came on the board of United States Steel in 1925 (Gary died in 1927). After Gary's death, Taylor became chairman of the finance committee, and J. P. Morgan became chairman of the board. J. A. Farrell, who had been president for some years, was designated "chief executive officer." Taylor succeeded Morgan as chairman in 1932, at which time the former also became "chief executive officer." See M. C. Taylor, *Ten Years of Steel*, address before the annual stockholders' meeting of United States Steel Corporation, Apr. 4, 1938.

[8] According to the company's organization chart, the engineering and production departments reported to the president. All others—including industrial relations and various departments concerned directly or indirectly with financial matters and sales—reported to the vice chairman, who, on the organization chart, was above the president. The vice chairman reported directly to the chairman.

[9] It was the arrangement which prevailed during the regimes of Young (chairman) and Swope (president) and of their successors. See *Fortune*, January 1940, pp. 68 ff.

[10] It was not the case under Gary. Since Taylor's reorganization of United States Steel, however, one-man rule has been succeeded by a group command. In 1941, for example, the president was in charge of operations; financial problems were handled by the chairman of the finance committee; the chairman of the board was in charge of public relations and was also supposed to exercise a general oversight of the affairs of the corporation. Certain broad problems were handled by all three men as a group. To an outsider,

situation existed in a number of the other companies studied.

In certain cases, the chairman's role is to serve, to put it rather unkindly, as a "front." This means appointing as chairman a man whose name or contacts have a certain public-relations value. A rather clear case of this existed at one time in a large firm producing an important industrial raw material. A similar situation seems to have existed in a prominent rubber company and also, at one time, in a large eastern railroad.

These various possibilities regarding the role of the chairman—as a completely or partially retired president, active head, specialist in financial and other matters, or figurehead—do not describe all the situations met in practice. In one company, for example, the president was the chief executive and the key figure, while the chairman was really the operating head serving under the president.[11] In at least one other company studied, the chairman was subordinate to the president, who was the chief executive officer.[12] A further variation was found in two companies in which the chairman at the time this survey was made was a former president who had been "kicked upstairs" by a new group in control of the company.

In a few companies the key figure in management is the chairman of a standing committee of the board, rather than the president or chairman of the board as a whole. This was

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the role of chairman of the board in this arrangement seemed uncertain. It might be ventured—and this is merely the writer's opinion—that this role was as yet probably not clearly demarcated. What it will be eventually in all probability depends on what the present incumbent makes of it. It might be noted that the company's by-laws were changed in 1938. Under the revised set-up the chairman was no longer specifically called the chief executive officer, and the president was given the new title of "chief administrative officer." See the company's by-laws, as amended in 1938, and the *New York Times*, May 13, 1938.

[11] This situation has since changed. Upon the death of the president in 1940, the chairman became the chief executive officer, the new president being designated second in command. *New York Times*, Nov. 28, 1941.

[12] Information supplied by the company. In this second company, the chairman mentioned has since retired and the former president is now chairman and still the chief executive officer. The former chairman became increasingly inactive in the years preceding his retirement.

true of Gary in the years 1901-03.[13] In a western railroad, the chief executive for a while was the chairman of the executive committee. In 1939, an internal reorganization in the North American Company led to the president's becoming chairman of the executive and finance committee and to the appointment of an operating president.[14] The former chairman of the executive committee became chairman of the board. The new committee chairman was to have charge of the financial and legal side of the company's business and was to supervise the company's integration and reorganization plans.[15] In this capacity, he was undoubtedly the key figure in the company, as he had been as president.

Whatever his title, the chief executive in our largest corporations is not ordinarily the type of creative and aggressive business leader who is both famous and infamous in the annals of American industry. He is not the restless dynamic individual of an earlier generation who, owning his company, pioneered into new lines and "risked his shirt" building up a new business organization. Rather, he is a professional executive doing a "management" job—co-ordinating his firm's activities, approving decisions that flow up to him from his subordinates, but doing less and less initiation.

This is only natural. These larger firms are not only large

[13] See Ida Tarbell, *The Life of Elbert H. Gary* (1925), pp. 150-51. To take another case, a well-known figure in the oil industry has been successively president, chairman of the board, and chairman of the executive committee in his company. In all three capacities he was the key figure, though in recent years he has to an increasing degree left the day-to-day management in the hands of a president and an executive vice president (who is also chairman of the finance committee).

[14] The background of the new president, E. L. Shea, aroused considerable interest at the time these changes were made. Mr. Shea had been executive vice president of Tide Water Associated Oil, and his business experience had been confined to (natural) gas and petroleum operations. The appointment was unusual in that a man with no experience in the utility field became operating head of a public utility system. Ordinarily operating heads of utility companies are men with considerable experience in the utility industry. This sort of industrial inbreeding is today practically universal in the railroad field. It exists, but is much less common, in the various industries that make up the so-called industrials.

[15] See *New York Times*, Nov. 2 and 19, 1939, and press release issued by the company dated Nov. 1, 1939.

but also relatively mature. For most of them the period of their most rapid expansion has passed. The great majority of them have reached the stage where the founder has retired or died, and nearly all are now led by a second, third, or later generation of chief executives. This is true above all for the railroads, but even among the younger industrials we have to deal for the most part with chief executives who are not the founders or chief builders of their enterprises—men whose job is to carry on rather than to build up a new organization.

A few of the large firms we are studying are still young enough to be under the command of their original leaders, but each year diminishes their number. Until a few years ago, Walter Chrysler headed the company that bears his name, but illness and finally death took him from the scene. In 1940, a Guggenheim still presided over American Smelting and Refining,[16] and H. F. Sinclair was still the key figure in Consolidated Oil. Neither was a large stockholder in his company. T. J. Watson was primarily responsible for building up International Business Machines and is still the head of that company. Other cases could also be mentioned.[17] Even some of these men, however—for example, Chrysler and Watson—could be accurately termed "professional executives." There are also a few large companies in which active leadership is, at least in part, exercised by direct descendants of the founder. In these cases, the chief executive is likely to be an important owner of the business.[18]

[16] He has since died. A member of the Guggenheim family by marriage, R. W. Straus, succeeded Simon Guggenheim as president in November 1941. At the same time, however, the by-laws were altered to make F. H. Brownell, who continued as chairman of the board, the chief executive officer. *New York Times*, Nov. 28, 1941.

[17] An example in the public utility field is Public Service Corporation of New Jersey, in which T. N. McCarter served as president from the founding of the company (in which he played a leading role) until 1939. After that, he occupied the newly created position of chairman of the board. See *New York Times*, Mar. 22, 1939, and *Fortune*, November 1934, pp. 100-01.

[18] Firestone Tire and Rubber is an example of a company in which the chief executive is not now a descendant of the founder but in which sons of the founder do participate in management. At the time this was written,

Recent illustrations include the du Pont company, Deere and Company, Colgate-Palmolive-Peet, and United Shoe Machinery.

On the other hand, we can point to many examples of the transition from the dynamic leadership associated with promotion and rapid growth to leadership by the "hired manager" type of professional executive. G. F. Swift built up the present meat-packing organization that bears his name. Today four sons still play important and active roles in the company, but the key executive positions are now filled by men outside the Swift family.[19] In International Harvester, McCormick family influence has been maintained through substantial minority stockholdings, but the active management of the company from 1922 to 1941 rested successively with three chief executives outside the McCormick family.[20] In Sears Roebuck, the original partners have long since gone; Julius Rosenwald is dead, and Lessing Rosenwald has re-

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J. W. Thomas, an early and close associate of the late Harvey Firestone, was president and chief executive officer. Harvey Firestone, Jr., was vice president, and his four brothers "are active and occupy important managerial positions." (Information supplied by the company.)

[19] The company's history thus far falls into three stages: (1) active leadership by G. F. Swift, the founder; (2) active leadership, including real management of operations, by the sons of G. F. Swift; (3) rise of a non-Swift to the presidency but continued (though less active) participation in management by the remaining members of the second generation of Swifts. The writer is indebted to Mr. H. H. Swift for valuable information on this company. See also L. F. Swift and Arthur Van Vlissingen, Jr., *The Yankee of the Yards* (1924), and T. W. Goodspeed, *Gustavus Franklin Swift, 1839-1903* (1927), reprint from the University of Chicago Biographical Sketches, Vol. 1.

[20] Cyrus H. McCormick, son of the inventor and founder of the McCormick Harvesting Machine Company, was president of both that company (1884-1902) and of International Harvester (1902-18). His brother, Harold F., was president until 1922. From then until 1941, the active chief executive came from outside the McCormick family. In 1941, Fowler McCormick, who had been an officer for some time, was elected president. See Cyrus McCormick, *The Century of the Reaper* (1931); Paul B. Coffman, *International Harvester Company* (a case study prepared by the Harvard Business School); *Harvester World*, July 1936; and Federal Trade Commission, *Report on the Agricultural Implement and Machinery Industry*, H. Doc. 702, 75 Cong. 3 sess. Additional information was supplied by the company.

tired from the business; General Wood served his term as president and became chairman.[21] In Goodyear, U. S. Rubber, and the B. F. Goodrich Company, professional executives are now at the helm[22]; so, too, in Packard, Chrysler, and General Motors; also in United States Steel and Bethlehem; and in the Texas Corporation, Tide Water Associated Oil, and the Standard Oil Companies.[23]

Sometimes reorganization or a struggle for control accelerates the transition from founder to professional executive. Financial difficulties in 1920 led to the displacement of Frank Seiberling in Goodyear Tire and Rubber and of W. C. Durant in General Motors.[24] In the first case an interlude of banker management was fairly quickly followed by the leadership of professional executives trained in the company. In General Motors, Durant the founder, promoter, and expansionist, was followed by du Pont minority ownership, with active leadership being assumed by Alfred Sloan. On occasion, as in the United Fruit Company, internal reorganization has led to the assumption of leadership by an individual—in this case, Samuel Zemurray—who more closely resembles the old-fashioned type of business leader than did those whom he succeeded.[25]

In the railroads, the professional chief executive is the universal rule—so much so that the railroad president who has not come up through the ranks (of his own or another railroad) is an extreme rarity.[26] The age of pioneering and of

[21] *History of Sears, Roebuck and Co.* (mimeo. pamphlet published by the company); *Fortune*, May 1938, pp. 66 ff.; *New York Times*, Jan. 29, 1939.

[22] However, D. M. Goodrich was chairman of the board of the company bearing his father's name. He did not seem to participate as actively in management as the other top officials. See H. and R. Wolf, *Rubber*, p. 462.

[23] See the annual reports of these companies. There are informative articles in *Fortune* on practically all of these firms. Other sources are mentioned in later references in this and subsequent chapters.

[24] On the Goodyear case, see H. and R. Wolf, *Rubber* (1936), pp. 447-57; Hugh Allen, *The House of Goodyear* (1943), Chap. 3. The General Motors story is discussed at greater length in Chap. 8.

[25] See *Fortune*, March 1933, pp. 26 ff; *New York Times*, Feb. 1, 1938.

[26] See TNEC, *Bureaucracy and Trusteeship in Large Corporations*, Monograph No. 11, pp. 24, 46; *Fortune*, April 1938, pp. 156-58.

building new railroads is long past; so is the age of Vanderbilt, Hill, Harriman, and the "Big Four." The public utilities are younger, but their period of promotion and rapid expansion is largely over also. Here, too, the chief executive tends to be the professional manager type, and, as in the railroads, his background is likely to have been confined to that one industry.

DECISION-MAKING AND THE DIFFUSION OF RESPONSIBILITY

In Chapter III we separated the job of business leadership into three component elements: initiation of decisions, approval of decisions, and co-ordination. Of these three elements, co-ordination is the only one which cannot be delegated to officials below the chief executive. It is not generally recognized, however, how far the responsibility for the other two elements, initiation and approval of leadership decisions, has been diffused through the executive hierarchy.

Every firm must go through a continuous process of adjusting itself to changing conditions. It therefore needs one or more sets of eyes, to see changes as they occur and to recognize the need for action. The fortunate business will have at least one set of eyes that *fore*sees, that looks into the future and anticipates changes, as well as recognizing them when they occur. After a change is recognized, a decision as to a new line of action must follow. This is the process of initiating business decisions—including those which may be called policies.

The function of initiating and formulating decisions in the large concern may be carried on in both the upper and the lower levels of the executive hierarchy. The chief executive may be the one to see the need for action. Having done so, he may either refer the matter to subordinates to formulate a plan of action, or he may prepare the plan and thus complete the initiation of the decision himself. Decisions may also originate in the lower levels of the executive organization. Sales managers, production heads, functional vice presidents, and others may see the need for doing something

and formulate suggestions or plans for taking action. Such initiation, if the decisions are important enough, constitutes part of the leadership function. These decisions, in the form of suggestions and recommendations, may now have to flow upward for approval by a higher authority—a functional vice president, a committee, the chief executive, or the board. But the initiation in this case has come from below.

With the growing size and complexity of corporate organization, power and responsibility have been increasingly delegated to officials below the rank of chief executive. As this process of delegation has gone on, more and more are the eyes of large-scale business appearing at the lower levels of executive authority. Initiation in these cases includes not merely recognizing or anticipating the need but actual formulation of plans for action. That the plans may have to be approved by someone in higher authority is perhaps less important than the fact that without this initiation from below there would not be these plans to approve.

Initiation of decisions below the rank of chief executive is not confined to petty matters. Nor is it confined merely to adjustment to a changing market situation. As we shall show later, such initiation from below may include important acts of innovation—programs of expansion, plans for new products, important changes in production techniques, and the like.

Approval of major decisions (after real consideration, not the routine sort that automatically follows recommendation) is decentralized less than initiation. The "average level of authority" at which major decisions may be approved is substantially higher than that at which they are initiated.

In the very large corporation, the chief executive cannot reserve to himself the full and complete exercise of the approval function. Final responsibility for permitting proposals to be embodied in action must be delegated to some extent. Functional vice presidents and various committees may be given the right to exercise a final veto over decisions originating from below (as well as those which they themselves initiate). The approval power may be delegated still further—

to heads of departments and subsidiaries, factory superintendents, sales managers, and so on. Formal and informal rules emerge to allocate responsibility; that is, criteria are set up to indicate how high plans must go in the organization before final approval can be secured. Some types of policies may always go to the chief executive (or higher); other policies may receive final approval from a vice president or committee of executives. Cutting across the criterion of *kind* of decision is usually some sort of criterion of importance. For example, all "major" decisions must go to the chief executive; or, to cite a less vague criterion, appropriations above a specified amount must be approved by the chief executive or perhaps the board or one of its standing committees.

The degree to which the approval function has been delegated varies widely among large corporations. In general, the tendency in the last generation has been toward greater decentralization. This term, however, needs to be defined. Ordinarily, decentralization means to the corporation executive that some degree of independence of action has been granted to regional and departmental heads; approval of the central staff in the executive offices does not have to be received on a given range of problems. It is in this sense that the term "decentralization of authority" is perhaps most widely used, and in this sense it has been increasing among large companies.[27]

[27] At one time, the du Pont company had a strongly centralized organization along functional lines. After the First World War, considerable diversification took place, and authority is now decentralized by products and type of manufacture, with a general manager or president (if a department is run as a separate subsidiary) in charge of all operations for a particular group of products. Departmental managers and heads of subsidiaries are allowed considerable latitude. (Case study prepared by the Harvard Business School.)

Another company having marked decentralization in this sense is Deere and Company, whose various production and sales divisions have a considerable amount of independent authority. See *Farm Implement News*, Jan. 14, 1937, p. 63; *Fortune*, August 1936, pp. 159-60.

See also the following: "There has also been a tendency in the past few years toward decentralization of management which to a large extent overcomes the undesirable features of central control. Comparatively independent operating divisions have been set up, which are practically equivalent to

For our purpose, however, there is another meaning of "decentralization of authority" which we may call "individual" or "functional" decentralization—since it is usually on a functional basis. We have reference here to the tendency to divide "top management" among specialists—the vice presidents, treasurer, and so on. Considering these two meanings of decentralization together, we may have a company in which responsibility is relatively centralized, in the first sense, and highly decentralized, according to the second definition. Such cases are common. In these cases, the autonomy of subordinates within any functional department is limited, while at the same time there are a relatively large number of functional heads, each of whom may have considerable leeway in the approval of major decisions.[28]

In practice, various degrees of the two kinds of decentralization exist together. Functional heads may serve chiefly in

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separate companies except in certain financial obligations to the parent company. While not an entirely new practice, it has found increasing favor in recent years." Howard Coonley, "How Big Should A Business Be?" *The Journal of Marketing*, Vol. 5 (1940), p. 106.

[28] In a company engaged in mining and refining non-ferrous metals, there were vice presidents in charge of mining, smelting and refining, sales, law, finance, and traffic and purchasing. Each was "given wide latitude in framing the policies of his department." A vice president could, on his own authority, shut down a mine, but he would have to reach an agreement with the other vice presidents affected. In the case of a radically new policy, the vice president would confer with the president and chairman. (Case study prepared by the Harvard Business School.)

Another example of centralized authority within functions but delegation of considerable responsibility to specialists in charge of functional activities is found in the relation between the staffs of subsidiaries and the staff of the American Telephone and Telegraph Company. See Federal Communications Commission, *Investigation of the Telephone Industry in the United States*, H. Doc. 340, 76 Cong., 1 sess., pp. 103ff. See also *Telephone Investigation*, 1935-1937, Pt. 31: *Comments Submitted to Federal Communications Commission by American Telephone and Telegraph Company on Commission Exhibit 2096 G*, pp. 74-76. (The company has objected to many statements in the FCC's report on the grounds of inaccuracy and one-sided interpretation, and has published a brief and a series of pamphlets dealing with the report and the Commission's supporting evidence. Where controversy existed, I have weighed both sides of the case and drawn my own conclusions. Where the FCC report is cited on a controversial point, reference will be made also to the company's answer as given in its brief or pamphlets.)

a staff (advisory) capacity, approval of major decisions being concentrated in the chief executive or a committee. while at the same time considerable autonomy is given officials in the factory and the field.[29] Or some specialists may have important functional authority, while others do not. For example, the financial officer may serve solely or chiefly in the capacity of adviser to the chief executive, while the vice president in charge of sales may have wide discretion in the determination of prices and selling policy.

DECISION-MAKING BY EXECUTIVES: OPERATING DECISIONS

A rough but not altogether satisfactory distinction may be made between operating and non-operating decisions. The former have to do directly with making and selling the goods or services which the firm has to offer. We should include here decisions as to price, changes in output, advertising, purchasing and sales matters, and so on. The non-operating decisions have to do with broader questions of finance, public relations, perhaps labor policy, and the like.[30] In general, as we should probably expect, this latter group of decisions is subject to less delegation than operating decisions.

The tendency toward increased functional specialization in large business enterprises has naturally been accompanied by increased delegation of operating decisions. In some cases,

[29] The General Motors organization represents a high degree of both kinds of decentralization. Functional officers in the New York office act chiefly in a staff capacity, and the divisional heads have considerable autonomy. Control over divisional heads is exerted chiefly through committees—the administration and policy committees and so-called "policy groups." As an indication of decentralization in our first sense, no staff officer can overrule the head of a division. The nature of decentralization in the second sense is indicated by the fact that there are eight "policy groups," in addition to two general management committees, the president, chairman, and regular staff officers. See *Fortune*, April 1938, pp. 76-77,114; December 1938, pp. 41 ff.; *New York Times*, May 4, 1937. (Information concerning General Motors, on this and other points, has been supplemented by interviews with executives of the company.)

[30] A good many labor questions could perhaps more appropriately be considered as falling in the operating category. Some readers might also prefer to consider major decisions on such matters as price and sales policy as non-operating decisions.

this has meant more centralization in the executive offices, but in all cases it has meant less centralization in the chief executive. As business firms grow larger, the making of important operating decisions is being entrusted more and more to specialists or departmental managers at the level of authority immediately below the rank of chief executive.[31] Functional vice presidents may initiate decisions on many problems in their particular fields—for example, in the matter of prices and selling tactics—and are likely to have an independent power of final approval over many important matters.

Delegation of responsibility in connection with operating decisions holds particularly for initiation, but also to a considerable extent for approval. There is no general rule that certain types of decisions always go to the top for approval, while others do not. For all of the companies taken together, the closest approximation to such a rule seems to be that the chief executive tends to be least active in decisions leading to changes in production technique and to short-period fluctuations in output. But the types of decisions the chief executive emphasizes depend on the industry, the company, and the man. In an industry where marketing strategy is important,

[31] In the recent internal reorganization of United States Steel, this tendency clearly showed itself. Formerly, there had been one-man rule of this parent company, which meant, among other things, inadequate control over the heads of the subsidiaries. Under the reorganization, operations were set off from financial and certain other general types of policy. Operating control was centralized in the president of the parent company and the executive committee of a management subsidiary, and, within the broad category of operations, functional specialists were given centralized supervision over the activities of all subsidiaries relating to particular functions. Under this reorganization, both the chairman of the parent company and the heads of the subsidiaries gave up some control. What they gave up went to President Fairless, the executive committee of the management subsidiary, and functional vice presidents. Under the old regime of Gary, one-man control of operations had actually meant control by too many men.

In a large soap company, the man who guided the company for many years and was responsible for building it up to its present size had only one vice president (for financial affairs). Control of all operating matters was vested in the president. Today, there is a good deal of specialization at the vice president's level; there are vice presidents in charge of finance, purchases, sales, manufacturing, and advertising and promotion. Here also these functional specialists act on occasion as a committee with considerable power.

for example, the chief executive may play a particularly active role in directing marketing activities. G. W. Hill's oft-cited leadership in formulating advertising policies of the American Tobacco Company might be cited as an example.[32] Advertising is a more important factor in selling cigarettes than is price competition. The background and personal characteristics of the chief executive also help to determine which kinds of decisions are likely to be delegated and which centralized in him. The man with a legal or financial background is likely to emphasize those aspects and to rely heavily on functional specialists in matters affecting sales or production organization.

In all the companies studied, there seemed to be some vaguely held criterion of importance; decisions deemed sufficiently important by this standard went to the chief executive for approval. The criterion varied, but in general it was likely to be based to a considerable extent on financial considerations. Matters involving questions of broad strategy were also likely to go to the chief executive.

Prices. Among operating decisions, questions of price determination come first to mind. In the companies studied, the chief executive was in all cases responsible for *some* price decisions—not necessarily as initiator, but certainly as approver. In general, approval of the chief executive was necessary when a major change in policy was being considered—"policy" in the sense that the contemplated act laid down a criterion for future action. Thus, in a prominent oil company, regional managers were permitted to change prices to meet competition, in line with certain broad policies established at the top.[33] Similarly, in a well-managed steel company, the

[32] See *Fortune*, December 1936, pp. 154 ff. According to a letter from the company, Hill devoted a good deal of his time and thought to the advertising policies of the company and had originated many of the company's most successful advertising campaigns. Though advertising was his forte, he had also originated successful ideas in purchasing, manufacturing, and selling.

[33] Information supplied by the company. In another oil company, price changes were approved by the vice president in charge of marketing. The president was consulted in "crucial situations." In supplying this information, the company made no mention of the chairman, who is not inactive.

vice president for sales made "routine" price decisions, but "very important" matters were referred to the president.[34]

In many companies, a powerful committee of executives was responsible for major changes in price policy, while considerable leeway was granted subordinates in establishing and changing prices for individual products and in negotiating with customers. Frequently, even when the chief executive made the decision, final approval was really a joint product resulting from conferences with subordinates.[35] If there were

[34] Information supplied by the company. In this connection, an item in the testimony of Mr. Grace of Bethlehem Steel before the Temporary National Economic Committee is of interest. The schedule of "extras" developed in 1938 by the steel industry, involving important changes in classification and prices of particular steel products, was initiated and put into final form for recommendation by subordinate functional specialists and approved by a vice president in Bethlehem Steel. It did not go to the president at all. TNEC Hearings, Pt. 19, p. 10622. In the case of United States Steel, where greater importance was given to this matter, the company seems to have taken the lead in the negotiations, and the changes were submitted to the president. (The same, pp. 10566-68). For excellent material on methods of setting prices in various steel companies, see these Hearings, Pts. 19-20, particularly the testimony of President Fairless of United States Steel Corporation in Pt. 19.

[35] Thus, in a company manufacturing certain types of building materials, it was stated that "the president is in active touch with the price situation" but that he accepts subordinates' suggestions as to price changes to be made. The following, concerning the International Harvester Company, is also pertinent: "In common with most very large concerns, there is no single official of the company charged with sole responsibility for deciding upon price changes or upon price policy generally. In the case of the International Harvester Co., such decisions are made in conferences attended by the executive officials and representatives of various major departments of the company—sales, accounting, engineering, and manufacture. [The following footnote appears at this point: "The specific officials of the International Harvester Co. who take part at various stages in pricing decisions are the president, first vice president, second vice president in charge of manufacturing, vice president in charge of engineering, vice president and general counsel, vice president in charge of sales, treasurer, and comptroller. All of these officials have been associated with the International Harvester Co. for many years."] These conferences usually decide upon the changes to be made in the prices of a few typical implements; the prices of the full line of machines are then fixed by the sales department in accordance with certain dollar differentials between the typical machine and other similar machines." [The following footnote appears at this point: "Changes in these differentials are also made in most cases by the sales department."] TNEC, *Industrial Wage Rates, Labor Costs, and Price Policies*, Monograph No. 5, p. 81.

both a president and an *active* chairman, important price decisions (where they were not finally made by committees) were in some companies approved by the chairman, but in others the president assumed final responsibility.[36]

The kinds of price decisions for which the chief executive's approval is required depend on a number of factors. If a firm produces or merchandises a large number of unrelated products, the chief executive will concern himself with profit margins but not with individual prices.[37] If a firm produces only a few products, or if its products are so closely interrelated that a change in the price of one necessitates a change in the price of others, the chief executive may consider in detail individual price changes.[38] In general, the chief executive approves specific price changes when, because of the magnitude of the change or because most of the firm's products are affected, they are expected to have an important immediate effect on total revenues.[39] In addition, the chief executive normally approves the formulation of such price or marketing policies as affect to a significant degree the firm's relation with

[36] Thus, in one company manufacturing machinery, the president was the final price-making authority and the same was true in a large oil company. Both companies had active chairmen, though at the time this study was made the one in the oil company no longer devoted the major part of his time to the company's activities. In a large merchandising concern, on the other hand, the chairman was responsible for major changes in price policy. The same was true in a large operating utility.

[37] The obvious example of a company in this position is the large department store, in which "buyers" for individual departments set the prices. In a large merchandising concern studied (not a department store), the chief executive set the gross profit-margin to be aimed at, but did not concern himself with individual prices. His approval was necessary in price decisions which significantly affected his firm's relations with important competitors.

[38] But even here, determination of differentials, which results in setting prices for particular products, may go no higher for approval than a vice president or sales manager. See the references on this to Bethlehem Steel (p. 82, note 34) and International Harvester (p. 82, note 35).

[39] As firms grow and branch out into new products, the control of the chief executive over individual prices steadily weakens. As this occurs, the price-making function, always a sacred prerogative of the entrepreneur of economic theory, shifts more and more to product and functional specialists who are, even more than the chief executive, the "hired manager" type of decision-maker.

important competitors or customers. An example of such a policy would be one giving subordinates the right to meet immediately, without the chief executive's approval, price changes initiated by other firms.[40]

A certain amount of *initiation* with respect to price decisions also takes place at the top. This is less likely to be true when "the top" (as far as price decisions are concerned) is a committee rather than an individual. Cases of formulation of price policy by the dominant executive in a company include Gary's activities in the interest of price stabilization in the steel industry,[41] Harvey Firestone's price leadership in the tire industry,[42] and Daniel Willard's efforts on behalf of passenger fare reductions in the railroad field.[43]

In general, however, initiation of important price changes does not come from the top, and frequently even approval may not go higher than a vice president—or, in a company with an active chairman who is the chief executive, the president (who in this case may be the chief operating officer). The initial setting of prices when a firm originally enters the market, as well as later adjustment, is also likely to be handled and approved by officials below the level of the chief executive. With the great diversity of products that characterizes so many large corporations, this is inevitable.

This diffusion within the firm of the price-making function takes on special significance, when we consider that in a market dominated by a few large sellers each company has considerable discretion in the prices it chooses to set. Unless an active chief executive initiates price changes himself, pricing is likely

[40] Thus, in the steel industry, concessions from posted prices to individual customers to meet competition do not necessarily go above a regional sales manager or, in important cases, the vice president in charge of sales.

[41] See Arundel Cotter, *United States Steel: A Corporation with a Soul* (1916), pp. 222-29; Tarbell, *The Life of Elbert H. Gary*, pp. 205, 210 ff.; *United States Steel Corporation*, Hearings before the House Committee on Investigation of United States Steel Corporation (1912), pp. 75 ff., 262 ff., 372-73.

[42] See H. and R. Wolf, *Rubber*, pp. 445-46 and Bk. 5, Chap. 3.

[43] A good deal of the more routine type of rate-making in the railroad industry seems to take place below the chief executive's level. In this connection, industry associations of men below the top management level, as in regional rate bureaus, are important.

to become a problem of "adjustment" rather than "innovation." The pricing process becomes routinized until a venturesome executive in a competing company creates a new market situation, which is forced on the attention of the chief executives of all the companies in the market. Economists have considered the problem of price rigidity almost exclusively in terms of the organization of markets and similar factors largely external to the firm. The internal organization of the firm is also a factor which needs to be taken into account in this connection.[44]

Marketing problems. The procedures just described for the handling of price decisions are largely duplicated in the sphere of marketing activities. By marketing we mean, on the selling side, all activities (other than price changes) aimed at facilitating sales. Included in this category are advertising and other sales promotion activities and attempts to shape and control the channels of distribution. On the buying side, marketing includes the direction of purchasing activities.

In the making of marketing decisions, nearly all companies studied showed a large degree of delegated decision-making. Delegation extended to approval as well as initiation. Many important types of marketing decisions received their final approval from a vice president in charge of sales or advertising, from officials at even lower levels of authority, or from committees of functional executives.[45]

[44] See E. S. Mason, "Price and Production Policies of Large-Scale Enterprise," *American Economic Review*, Vol. 29, Supplement (March 1939), pp. 66-68; also pp. 333-35 below.

[45] In a large chemical company, for example, considerable leeway was granted the operating heads of individual departments and subsidiaries as well as the director of advertising for the parent company. The executive committee of the board (made up entirely of full-time operating executives) approved advertising (and other) appropriations, but in the matter of advertising great weight was given to the recommendation of the director of advertising. In a food products concern, for which non-price competition was very much more important than competition based on prices, a vice president had final responsibility for most marketing activities. A good deal of discretion in formulating selling policies was also exercised by officials below this vice president. Similar situations existed in other industrial companies. In railroads and public utilities, the delegation is, if anything, even more pronounced.

As in the case of prices, some marketing decisions might, in any company, be deemed important enough to necessitate formulation or approval by the chief executive. In certain companies, particular types of selling and advertising problems were fairly regularly submitted to the chief executive. In numerous instances, a committee shared with individuals the final approval of important marketing decisions.

A considerable amount of initiation in selling policy seems to have come from certain chief executives. The case of Hill and the American Tobacco Company has already been mentioned. Thomas J. Watson is credited with building up the sales organization and selling policies of International Business Machines.[46] President Litchfield took full responsibility for Goodyear Tire and Rubber's famous contract with Sears Roebuck and Company.[47] Alfred Sloan, then president, was credited with revamping General Motors' dealer and distribution policy in 1933.[48] Where customers are few and individual orders are apt to be of considerable magnitude, the chief executive may even turn salesman on occasion—for example, Charles Schwab of Bethlehem Steel, Samuel Vauclain of Baldwin Locomotive Works, and Clarence Woolley of American Radiator and Standard Sanitary.[49]

Thus, while the delegation of marketing decisions has become quite pronounced, in not a few large corporations the chief executive is likely to be more active in this field than in the making of price decisions or the control of production technique.

[46] *Fortune*, January 1932, p. 37.

[47] H. and R. Wolf, *Rubber*, pp. 467, 472-73.

[48] *Fortune*, February 1939, p. 105.

[49] On Schwab, see Cotter, *The Story of Bethlehem Steel*, p. 34. Vauclain's selling activities are described in *Fortune*, December 1939, p. 56, and in a case study of Baldwin Locomotive prepared by the Harvard Business School. On Woolley, see *Fortune*, April 1935, pp. 81, 161, 162. In another case, Guy Vaughan, president of Curtiss-Wright, accompanied his technical staff to Los Angeles for the crucial negotiations with Douglas Aircraft over the type of engine to be installed in the DC-1 transport plane. (*Fortune* September 1938, p. 94.) Apparently Ernest Weir, chairman of the board of National Steel, handled or participated in negotiations with a large can company concerning a contract for tin plate. See extract of a letter in TNEC Hearings, Pt. 19, p. 10683.

Volume of output. The economist, especially in his work in price analysis, emphasizes the sort of entrepreneurial decisions which affect the volume of output in a given firm. Volume of output, unlike certain other factors concerning which business decisions are made, is not an "independent variable" for most companies. The rate of production must reflect numerous other decisions—as to prices, expansion of capacity, volume of advertising and sales promotion activities, purchasing and inventory policy, financial questions, and so on. It is true that practically all aspects of a firm's activities are interdependent, but rate of output in particular is a variable which reflects decisions made concerning other matters. In many large companies, perhaps in most, these other matters are settled first.

A distinction must be made between plans covering projected output, for a season, a year, or longer, and current decisions actually to produce, during a given week, month, or other short period, the volume of output called for in the light of existing policies and current sales and inventories. The longer-run plans may call for approval from the top; decisions as to the volume actually to be produced this week or month may very well be made by subordinate officials as a part of more or less routine management.

Production plans for the future are never the product of one man. They represent the joint product of individual executives and of committees at various levels of authority and in many different parts of the business. Forecasts, recommendations, and partial plans are made in various parts of the organization—and consultations are held among product managers and functional executives concerned with production, sales, finance, engineering, and other fields. Out of this initiation and planning come recommendations which are revised as they flow upward for approval. Throughout this process, production plans are considered in the light of other policies being formulated, or already existing, as to sales, finance, and so on. Final approval may come from the chief executive or, less often, a committee of the board. In some

cases, plans go no higher than a management committee or a vice president. Not infrequently, certain other more "fundamental" policies may be formulated at the top, and determination of a production plan in line with these policies may then be delegated to subordinates. The chief executive may not review the plan at all, when it is made, or at least not in any detail.[50]

Current decisions regarding short-term variations in output are frequently so routine as scarcely to fall within our concept of the leadership function. Daily, weekly, or monthly production schedules are likely to be made up by a planning or scheduling department at a level considerably below that of top-management. These schedules are in good part automatic reflections of current sales, existing policies as to various matters, and the system of production control being used. These routine output decisions are not so much a part of the leadership function as they are indications of how previous leadership decisions and current economic conditions are affecting the company's operations. They do not go to the chief executive for approval. The latter comes in contact with them through reports of results which are placed on his desk. It is entirely possible, however, that the chief executive may on occasion initiate an important short-period alteration in output, to anticipate an expected change in prices or for some similar reason.

Research and new products. In development work and the introduction of new products, diversity of practice in the making of important decisions also prevails. Some initiation comes from the top, and plans for research programs and the introduction of new products frequently go to the chief executive for approval. Where large expenditures are involved, and where a proposed new product would bulk large in the company's aggregate sales, approval from the top is

[50] For some discussion of how production plans are formulated in a number of large corporations, see P. E. Holden and others, *Top-Management Organization and Control*, pp. 84 ff.

generally necessary. As in other cases mentioned, the "top" may be the chief executive, a committee of executives, or a standing committee of the board. In the company whose organization chart was presented on page 59, new products generally originated in a "new work committee" and were submitted to the president for approval. On occasion, approval of the board might be necessary, though such approval was likely to be nominal.[51] In a company manufacturing building materials, new lines also originated in the lower levels and had to be submitted to the president. In a food products company, new items were handled by a new products subcommittee and the executive in charge of sales; higher approval was necessary only if a large appropriation was involved.[52] In the case of the periodic introduction of new models in the large automobile companies, a fairly complete plan was normally submitted to the chief executive and the top executives' committee for approval. The initiation was ordinarily from below.

In general, when the introduction of new products involves research and technical knowledge, the possibility of initiation by the chief executive is limited. Initiation from the top in such cases normally takes the form of encouraging research, suggesting lines of study, choosing technical experts, and so on.[53] In some cases, already existing products are

[51] Information supplied by the company.

[52] Information supplied by the companies. In a large merchandising concern, similarly, approval of the addition of new items to the company's line did not go higher than a merchandising vice president—unless a large investment was involved.

[53] The activities of the late Walter P. Chrysler apparently represented a good example of initiation along these lines. (See *Fortune*, August 1935, pp. 31 ff.) An alleged example of negative initiation, supposedly exercised jointly by the president and the director of technical activities in American Telephone and Telegraph was the decision in 1907 to postpone introduction of the hand-set or "French" telephone. (See N. R. Danielian, *A.T. and T.*, pp. 102-03; Federal Communications Commission, *Investigation of the Telephone Industry in the United States*, H. Doc. No. 340, 76 Cong. 1 sess., p. 257.) A. T. and T. denies that there was any undue delay in introducing the hand-set and maintains that the step was taken as soon as satisfactory equipment could be produced. *Telephone Investigation, 1935-1937*, Pt. 17: *Comments Submitted To Federal Communications Com-*

added to a company's line, either by developing new facilities to produce them or by purchasing the facilities of other companies. In these cases, initiation may frequently come from the chief executive.[54]

As has been mentioned before, practically all the companies studied are mature, well-established concerns. The period of rapid growth and of active initiation by the founder has passed. This is particularly true with respect to the more technical aspects of these companies' operations. The development of new techniques and of new products has become largely professionalized, and initiation tends increasingly to come from below. For progress on the technological front, the chief executive must rely primarily on his choice of men and on the advice of his functional experts—not merely his engineers and chemists, but also his men in accounting, advertising, sales, and production. He still must approve the more important decisions, but farseeing veto or approval cannot create what is not there to approve. And even the approval may not reflect the independent judgment of the chief executive so much as it does the consensus among his staff. These considerations apply, of course, not merely to the introduction of new products but also to the dynamics of price, marketing, labor, and other policies. Today, on all these matters, the chief executive's most important contribution on the side of initiation is likely to come not directly but indirectly through his choice of men, the encouragement and stimulation he gives them, and on the breadth of vision he brings to the approval function.

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mission by American Telephone and Telegraph Company on Commission Exhibit 1989, pp. 64 ff.

[54] Chrysler's acquisition of the Dodge company is a good case in point. An interesting recent case was Sewell Avery's reported initiation in adding certain new types of items to the line of Montgomery Ward. (*New York Times*, Apr. 26, 1940; *Time*, May 6, 1940.) The rapid expansion and adding of new lines by a food products company during the 1920's was generally attributed to a group of men—including the chairman, president, several other officers, and a banker member of the board. (Interview and *Fortune*, October 1934, pp. 122, 124.) See also pp. 92-93, below, on initiation of expansion programs by chief executives.

DECISION-MAKING BY EXECUTIVES: NON-OPERATING DECISIONS

As we have already indicated, there is likely to be less delegation of authority in the case of non-operating decisions than in the case of those which we have been discussing thus far. This holds for both initiation and approval.

The least amount of delegation is generally found in financial decisions. These include approval of appropriations, determination of capital structure, and decisions regarding the raising of funds, reinvestment policy, and similar matters. Financial expediency, even in the large successful company, is a paramount criterion for any type of action,[55] a criterion which ordinarily outranks that of profitability. As a result, those with the greatest power in the corporation—the chief executive and the directors if they are active—are more likely to devote their attention to the financial aspects of the company's affairs than to any other. This is not always true, and of course chief executives do not occupy themselves exclusively with financial questions. But there is a strong financial tinge to the activities of many chief executives.[56]

In all companies studied, approval of major acquisitions (of other firms) and of internal expansion went at least as high as the chief executive.[57] Normal procedure in the case of

[55] By financial expediency we mean the judging of any policy in terms of financial criteria—liquidity, availability of funds if borrowing is necessary, and so forth.

[56] The following, by a leading student of management, is of interest. The function of finance, as distinct from other management functions, "is concerned with the provision and allocation of capital. As such it is outside the province of management proper. . . . Management is concerned only in the use of capital, not in its provision." (Oliver Sheldon, *The Philosophy of Management* (1923), p. 52.) This is a narrow view of the role of management in the large corporation, a view which does not accord with the facts, at least among many large corporations in this country. Top management must concern itself with raising funds as well as with using them.

[57] We include decisions regarding expansion in this discussion of financial policy because financial considerations are likely to play the dominant role when they come up for approval, both because of the size of the appropriations involved and because they overlap such purely financial decisions as those dealing with reinvestment of earnings, flotation of securities, dealings with bankers, and so on.

internal expansion was for plans to be formulated by operating executives, perhaps in conjunction with the engineering staff and a financial vice president or treasurer, and for the matter then to go to the chief executive for approval. Final approval might come from the latter alone or from a formal committee or from informal discussion between the chief executive and one or more staff officers.[58] Usually large appropriations were considered by the board also, but in most of the cases studied approval by the board as a whole was nominal.[59] Whatever the method of origination, the chief executive always exercised, individually or with others, an active veto over internal expansion policy.

In the matter of external expansion, through acquisition by purchase, the chief executive is frequently initiator, as well as often approver of his own plans. In a number of the companies studied, the president or chairman was responsible for the important acts of acquisition during his tenure of office.[60]

[58] In the case of a large soap manufacturing company, for example, expansion programs often came up from below and were approved by the president and an administrative committee of executives. In one of the larger companies manufacturing tires and other rubber goods, expansion plans similarly came up from department heads; in this case, the final decision was made jointly by the president and the financial vice president. (In several other cases, a financial vice president played an important role in determining financial policy.) Similar procedures exist in numerous other industrial companies, and also in the railroads and public utilities. One interesting case concerned a food products company in which committee action was important in all types of policy formation. Plans for internal expansion were recommended by the company's merchandising and manufacturing committees and were approved in principle by the president (who was not very active), but final approval came from an "advisory committee" of top executives, who had to pass the appropriation involved. The members of this committee constituted a majority of the board of directors. In one of the best known public-utility systems, the subsidiaries submit estimates of their capital needs, which are approved first by the operating vice president and then by the president of the parent company. After this the president, financial vice president, and comptroller consider the problem of securing the necessary funds.

[59] But in a minority of the cases studied a standing committee of the board exercised a real veto over appropriations.

[60] "Responsible" in the sense of initiating and carrying through the acquisition. Sometimes formulating external expansion plans is done by two or more executives, for example, the president and chairman. *Fortune*, speaking of the acquisition of the Corrigan, McKinney Steel Company by

In the majority of cases, the executive's action seems to have required only nominal approval by the board. In some companies, however, a real veto power was held by an executive or finance committee which could have overruled the chief executive's action. In the railroad consolidation moves of the twenties, acquisition of the securities of other lines was, in many instances, apparently initiated, planned, and put into effect by railroad executives.[61] In the majority of the cases studied, there is little indication that the boards of directors of the acquiring railroads played an active role in either initiating or approving the acquisitions.[62] Responsibility for these purchases—many of which cost the stockholders of the purchasing companies dearly—seems to have rested primarily with the dominant executives of the companies involved.[63]

In determining the financial advisability of expansion, as well as in handling such purely financial matters as plans to raise funds, deciding on the nature of new security issues, dealing with bankers, and so on, a division of responsibility sometimes occurs at the top of the management organization. A company may have two ranking officers, for example, a chairman and a president—the former being responsible for financial policy, the latter, for operating decisions. Sometimes

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the Republic Steel Corporation, stated: ". . . the whole transaction, from the original idea to the final vote was the work of Mr. Girdler [then president and chairman] . . ." (*Fortune*, December 1935, p. 152). Whether this was completely true, in view of the existence of influential minority interests which might exert a real veto power in this company, the writer cannot say. But it certainly would describe the process of initiating and approving important acquisitions by many chief executives. The statement is probably approximately true for the Republic Steel case, also.

[61] This was not true of the Van Sweringen railroads, whose acquisitions (such as those by the Chesapeake and Ohio) were planned by the Van Sweringen brothers working through a series of holding companies.

[62] However, individual directors occasionally played an important role. See notes on pp. 136, 199.

[63] See the various reports of the "Wheeler Committee." Senate Committee on Interstate Commerce, *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Repts. 25 and 1182, 76 Cong. 1 and 3 sess., (various parts bearing different subtitles); also *Fortune*, June 1926, pp. 138-40.

it is a chairman of the finance committee, or the finance committee itself, that takes over final responsibility for financial policy.[64] In a few companies studied, financial policy apparently originated with a vice president and was approved jointly by the vice president and the chief executive. But in all cases, whatever the organization for approval at the top of the management hierarchy, financial decisions did go all the way to the top for approval.

Dividend and reinvestment policy represents another financial problem in connection with which the chief executive plays an important, frequently the dominant role. There is almost no delegation to subordinate officials, although sometimes a financial vice president or an advisory group of top executives may help the chief executive formulate dividend recommendations. The chief executive's recommendations are nominally subject to approval by the board of directors, but in practice boards in these large companies do not usually exercise the active control over dividend policy with which the textbooks credit them. The board itself seldom recommends a dividend but rather acts on recommendations brought to it by the chief executive or by a standing committee of the board (in whose deliberations the chief executive ordinarily plays an important role).[65]

[64] The finance committee of the board in the du Pont company may play such a role. In the United States Steel Corporation after Taylor's reorganization, operating policy was largely determined by the president with the assistance of a management committee, and, as we have seen, there was also both a chairman of the finance committee and a chairman of the board. Final approval of financial policy seemed to rest with the three top executives and the finance committee itself.

[65] In one company, dividend recommendations were made by the president, with the advice of a financial vice president and certain members (chiefly bankers) of the board. In another company, dividends were recommended by a formal group consisting of the president, chairman, and vice chairman. In a third company, the chairman, with the advice of a committee of officers, made dividend recommendations. In none of these cases did the board seem either to initiate or to exercise a real veto power over dividend proposals made by the chief executive. To cite another example, there is not much doubt that the stockholders of American Telephone and Telegraph owe the generous treatment that they have received to the dividend recommendations made by the president of the company,

Decisions affecting organization of the firm as a whole are also almost certain to go to the chief executive for approval and may be initiated by him. Matters of financial organization have already been mentioned. Decisions affecting management organization will be considered in connection with the co-ordination function of the chief executive. Decisions affecting legal organization—for example, attempts at corporate simplification—are also apt to be made—perhaps initiated, and nearly always approved—by the chief executive.[66] Frequently initiation in these matters comes from the company's counsel or a financial vice president. The game of creating and destroying subsidiary corporations (as legal entities) for particular purposes may be largely played within the confines of the legal department, but important changes in this respect are fairly certain to go to the chief executive for approval.

Labor matters are being handled by chief executives to an increasing extent. A good many important decisions regarding working conditions, terms of bargaining, and wages have been initiated in recent years by the chief executives of the companies studied. In practically all companies considered, significant labor decisions had to be approved by the president, and in a number of cases the main lines of the company's labor policy had been originated by the chief executive himself. Important acts of initiation on labor matters that originated at the top included the present anti-closed-shop policy of a large merchandising concern, collective bar-

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although the board, of course, had to approve these recommendations. In another large public utility, it was stated, decisions regarding dividends and reinvestment of earnings were initiated by the chairman, though members of the board were free in expressing their opinions.

In at least two of the companies studied, the chief executive did not play an active role in the making of dividend decisions, and other cases of this sort undoubtedly existed also. In several companies, a finance or executive committee either initiated dividend recommendations or exercised an active and real veto over proposals submitted by the chief executive.

[66] For example, the moves toward greater corporate simplification in United States Rubber and Pacific Gas and Electric were largely motivated by the chief executives of these companies, F. B. Davis and James Black.

gaining with the C.I.O. by "Big Steel,"[67] continuation of the 40-hour week by a large public utility after N.R.A., and the terms of settlement reached by the steel and automobile companies in the labor difficulties of 1936-37.[68]

Almost of necessity, a good deal of initiation and approval with respect to labor matters comes from below. By the very nature of the case, initiation of many important labor decisions must come from the director of the personnel department, the heads of operating departments or subsidiaries, or from men at yet lower levels of authority. Even final approval on matters of vital interest to the working force may on occasion come from these men rather than from the chief executive—for example, determination of wage scales in particular plants or subsidiaries, setting up of employee welfare plans, and so on. In cases in which approval of the chief executive is necessary, the opinion of the official directly in charge of labor matters may be decisive. But there is clearly more of a tendency for the chief executive to assume responsibility for important labor matters than was true ten or twenty years ago. Even in companies in which approval is mainly delegated by the chief executive, centralization of authority over labor matters in the hands of a specialist at the vice president's level is fairly common.

In the matter of public relations and dealings with the government, chief executives are assuming an increasing amount of responsibility. Public relations matters are more likely to come to them for approval than was the case twenty years ago, and decisions on these matters are much

[67] See *Ten Years of Steel*, address by Myron Taylor to the 1938 stockholders meeting of United States Steel Corporation; also *Fortune*, May 1937, pp. 91 ff. Gary was in good part responsible for the company's labor policy during his tenure. See Cotter, *United States Steel: A Corporation with a Soul*, pp. 4, 139, 246 ff.

[68] In some of these cases, for example, one automobile company and one steel company for which the writer has unpublished material on negotiations at that time, final decisions were truly group decisions, shared in by two or more executives.

more likely to originate at the top than was true then.[69] The greatest emphasis on public relations is probably still found among the public utility companies. In a large and successful operating company on the West Coast, for example, assumption of responsibility for public relations policy was considered particularly to be one of the president's main jobs. Mr. Willkie's activities in Commonwealth and Southern seem also to have emphasized public relations. Among industrials, the revised 1938 by-laws of United States Steel make the chairman responsible for public relations. General Electric's allocation of responsibility—sales and operations to the president, finance and public relations to the chairman—is well known.[70]

In a large number of cases, however, decisions concerning public relations do not go above a vice president, except when the issue involved is vital. Many decisions originate in the lower levels of authority and secure their final approval from a director of public relations, an assistant to the president, or a vice president. In the case of neither public relations nor labor problems do matters so universally go to the chief executive as is the case with financial decisions, although they are more likely to go to the chief executive today than formerly. Where public relations and labor problems are handled by subordinates, the latter are more apt to be functional specialists with a relatively higher degree of authority than was once the case.

It is difficult, and often purposeless, to make a distinction between the function of handling public relations and that of dealing with government agencies. The former is frequently

[69] The tendency toward increased emphasis on public relations began before that on labor problems. The railroads and utilities have been appreciating the importance of public relations ever since the first repercussions of a "public be damned" attitude began to make themselves felt. A marked increase in emphasis on public relations problems in many fields came during the 1920's, and again after 1933.

[70] But, of course, a good deal of initiation and even approval would take place at lower levels of authority in these companies.

a means of dealing with the latter. Probably most public relations work of the utilities, for instance, is aimed at affecting the attitude of regulatory agencies and legislatures. In some cases, however, the distinction is significant. Guidance of negotiations with governmental bodies is also likely to fall within the chief executive's province, although the details of actual negotiations may be left to subordinates. Sometimes the chief executive enters into the actual negotiations, as in arguments over proposals for rate changes, lobbying for or against pending bills, negotiations regarding important tax rebates or assessments, and so on.

Labor, the public, and the government are three of the most important groups affected by the large corporation. Wherever a powerful interest group exists, the chief executive is likely to reserve for himself the direction of relations of the firm with that group. This holds for bankers and other financial interests, large minority stockholders, important customers or competitors, and so on. The increasing tendency for the chief executive himself to handle public or labor relations can very largely be explained by saying that the power of the interest groups involved here has increased substantially in recent years.

CHAPTER V

THE EXECUTIVE GROUP AND THE PROBLEM OF CO-ORDINATION

With the diffusion and specialization of decision-making outlined in the preceding chapter, how does the large corporation ensure that the activities of its executives are adequately co-ordinated and that particular decisions are grounded on a sufficiently broad familiarity with the problems of the business as a whole? Two tendencies are particularly important in this connection: the wide use of the committee system and the increasing emphasis which the chief executive places on the co-ordinating aspects of his job.

GROUP ACTION IN DECISION-MAKING

As a matter of fact, the prevalence of group, instead of individual, action is a striking characteristic of management organization in the large corporation. In many cases, committees of executives have partially supplanted individuals in the formulation and approval of major decisions, and they frequently share with the chief executive the exercise of the final co-ordinating function.[1] Such committees of operating executives are generally more important in the process of decision-making than are the better-known standing committees of the board of directors, despite the fact that the latter are much more often advertised on the pages of the companies' annual reports. Even where formal management committees do not exist, group action frequently takes place through the medium of informal conferences, out of which may emerge decisions which are the product of no single individual.[2]

[1] A discussion of committee organization in large-scale enterprise will be found in P. E. Holden and others, *Top-Management Organization and Control*, pp. 59-73.

[2] See TNEC, *Bureaucracy and Trusteeship in Large Corporations*, Monograph No. 11, p. 26.

Management committees are ordinarily of two kinds: the functional committee and what may be called the general management committee. A company may have several functional committees, each confining its attention to a particular type of activity—production, engineering, marketing, and so on. Such committees usually have limited authority and are normally located one or more grades below the chief executive. General management committees, on the other hand, are usually made up of the chief operating officer and other major executives. These committees do not confine themselves to particular functions and usually possess a good deal of authority. In many cases, final approval of (not necessarily all) major decisions comes from such a group rather than from the chief executive as an individual.[3]

Examples of functional committees have already been mentioned in connection with the introduction of new products. Thus, in one company, new products were initiated in a "new work" committee; in another, by a research committee. The latter company also had committees for manufacturing, merchandising, advertising, auditing, and investments. All of these were subordinate to a general executives' committee, called the advisory committee, which as a group had great power.[4] Numerous other examples could also be mentioned.[5] In general, these functional committees handle routine management problems and initiate more important decisions, which are then referred to those higher in authority for approval.[6]

[3] General management committees may also exist in subsidiaries or departments devoted to particular products. In such cases their authority is more limited than that of the general management committee of the parent company's major executives, and their activities concern only the particular department involved.

[4] Information supplied by the company. The most important functional committees were those for merchandising and manufacturing.

[5] See Holden and others, *Top-Management Organization and Control*, pp. 66-73.

[6] Some companies have a system of periodic conferences, which are in addition to or a substitute for standing committees. Such conferences are ordinarily held when departments or subsidiaries are widespread geo-

The most interesting exception to the rule that functional committees have limited powers was probably found in the case of General Motors Corporation. In this company, there were eight so-called "policy groups," which stood, in the company's organization, immediately below the policy and administration committees.[7] There was a policy group for each of the following: distribution, engineering, manufacturing, public relations, labor relations, overseas operations, executive personnel, and finance.[8] These groups "were set up to deal with 'policy formation' in each of the important functional activities of the Corporation. . . ."[9]

More important than functional committees ordinarily are what we have called "general management committees."[10] They bear various titles: "executive council," "advisory com-

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graphically. We have in mind here not so much the usual form of "get-together," the purpose of which is to maintain an *esprit de corps* and to stimulate effort, but rather the sort of conference of functional specialists which exercises an active initiating, if not an approval function. In the American Telephone and Telegraph Company, a number of such conferences are held. They include, among others, separate series of conferences on public relations, rates, legal matters, personnel, plant engineering, other engineering problems, general operations, management problems, and commercial (sales) matters. See FCC, *Report on the Investigation of the Telephone Industry in the United States*, p. 116.

[7] The latter two committees supplanted the old finance and executive committees of the board in 1937. See the company's annual report for that year and *New York Times*, May 4, 1937.

[8] See the organization chart in *Fortune*, April 1938, p. 76. An organization chart prepared by the company in September 1940 listed also policy groups dealing with "social and economic trends" and "production schedules."

[9] Annual report of the company for 1937. The report continues: "The purpose of these groups was to promote a better operating technique in the functional activity with which each was to deal, and out of such better operating technique were evolved forward operating policies to govern administration. The fact cannot be denied that as a result of this plan, progress was importantly stimulated." According to *Fortune*, "General Motors' real instrument panel is the series of Policy Groups—small committees, each of which is composed of several operating executives plus at least one member of the important Policy Committee. These groups, and indirectly the Policy Committee, review all executive plans that call for fresh capital outlay or major changes in design." (*Fortune*, April 1938, p. 76.)

[10] For some discussion of this type of committee, see Holden and others, *Top-Management Organization and Control*, pp. 22 ff.

mittee," "administrative committee," and so on. Normally these committees are made up of the president or chairman and other top-management officials. Some but not necessarily all of these executives are usually also members of the board. Such committees, where they are active, operate in one or more of three capacities: as group advisers to the chief executive, as collective initiators of decisions to be approved by the chief executive, or as an independent approving and co-ordinating body. In practice the advice of these groups, even when they serve in an advisory capacity, is often tantamount to final approval.

Frequently these committees are relatively small compact organizations whose membership does not extend below the vice president's level. Thus in the company mentioned on pp. 58-59, the executive council was made up of the nine chief officers. In a large soap company, there was an administration committee of the president, comptroller, and the various vice presidents. In a prominent steel company, a committee of the chief executive, three vice presidents, and the sales manager met every Saturday morning.[11] The smaller the group and the more it is made up of top executives, the more active and powerful it is likely to be. But larger groups also may be very influential. In a rubber company, an important operating committee included the top executives of the parent company but also the heads of departments and subsidiaries. A prominent automobile company, even when its founder was alive, had a formal operating committee of 26 executives whose unanimous decision was final.[12]

Committees of this general management type are also found among the public utilities and, to a less extent, apparently, among the railroads.[13] Each of the major operating

[11] *Fortune*, September 1933, p. 55. In Bethlehem Steel, a small group of key executives, chiefly the president and vice presidents, were reported to meet daily. Testimony of Eugene Grace, TNEC Hearings, Pt. 19, p. 10586.

[12] Information supplied by the companies concerned.

[13] In a large eastern railroad, for example, the president conferred every Monday with his vice presidents. This group did not constitute a formal committee, however, and no votes were taken.

utilities studied had such a committee, usually made up of the president and the various vice presidents. Not all were equally active or possessed of the same degree of power.

The stronger and more active of these committees meet frequently. Two thirds of those for which information was available convened weekly. One met daily; none less often than twice a month.

Problems considered usually range over such fields as production, engineering, sales, prices, labor relations, and new products and processes.[14] Financial and legal matters are frequently not included. Many of the general management groups might be (and sometimes are) called "operating" committees. That is, they deal with "operations" as distinct from financial, legal, and public-relations matters. This is not always the case, however. In a food products concern already mentioned, the chief management committee approved appropriations and otherwise had taken over many of the functions of a relatively inactive president.[15] In another food products company, an informal committee of the three sons of the founder (all officers), the president, and the treasurer acted as a powerful policy-making group concerning practically all aspects of the company's operations.

A variation of the general management committee exists in such companies as du Pont, Standard Oil (New Jersey), and, to some extent, United States Steel (through a management subsidiary). In these companies, the management committee is officially a standing committee of the board of directors. (In United States Steel, it is a committee of the directors of the management subsidiary.) In all these cases, it is called the executive committee. It should be emphasized here that we are not referring to all executive committees—many boards have them—but only to those, made up completely of full-time executives, which continuously and actively

[14] Thus, in General Motors, "All operating responsibilities, except those of a strictly financial and legal character, were transferred to the jurisdiction of the Administration Committee." Annual report for 1937.

[15] Information supplied by the company, which stated that all important matters are referred to this committee for final decision.

exercise some part of the leadership function.[16] In the du Pont company, the executive committee, made up of the president and eight vice-presidents, was an active approving and co-ordinating body, meeting weekly.[17] In the Standard Oil Company, all directors were officers,[18] but, in addition, there was an executive committee of certain members of the board which met daily. This committee exercised an active co-ordinating control over subsidiary companies.[19] (The parent is a pure holding company.) In the case of United States Steel Corporation, members of the committee were officers of either the parent company, the management subsidiary company, or operating subsidiaries. This committee and the officers of the management company dealt primarily with co-ordinating production, purchases, sales, and labor relations—but not to any considerable extent with finance, public relations, or certain other broad problems handled by the officers and finance committee of the parent company.[20]

In addition to joint action through formal groups, the informal conference is a practically universal means of securing collective decision-making. In a rubber company and in an automobile concern, for example, the president and a financial vice president made many decisions together. The president and an active chairman, or the president and an executive vice president, may work out many problems together.

[16] There were, in addition, a number of companies in which officers constituted a majority of the executive committee.

[17] See annual report of E. I. du Pont de Nemours and Company for 1937; also a case study prepared by the Harvard Business School.

[18] Not all of the directors are called officers, but those who are active are full-time, salaried, working officials. In the words of W. S. Farish, the company's president, "We have 10 board members, two of which are inactive. We have eight members of the board, and it is a working board and everyone of them is there every day, and everyone of them has a definite, particular job." (TNEC Hearings, Pt. 17, p. 9665.) This testimony was given in 1939.

[19] See annual reports for 1934-37; *The Lamp* (published by the company), October 1927; and *Fortune*, June 1940, pp. 62-63. See also TNEC Hearings, Pt. 17, p. 9665.

[20] See *New York Times*, Dec. 9-10, 1937; *Fortune*, March 1940, p. 150. Some evidence on how the responsibility for price decisions was shared among these officials is given in TNEC Hearings, Pt. 19, p. 10485.

Frequently, when individual matters are brought to a chief executive's attention, the final decision in each case is the joint product of the chief executive and the particular subordinates who are consulted. In many such cases, the fact that the superior officer has a final veto power is less important than the fact that in the exercise of that power the opinion of the subordinate carries great weight. Such meetings of minds, between superiors and subordinates or between men on the same level of authority, take place continuously in almost any company. This sort of informal group action permeates the entire management organization in practically all large corporations, and out of such meetings of minds many group decisions emerge.

The prevalence of formal management groups, as well as the even greater prevalence of informal group action, is intimately related to the size of the large corporation and, as we have mentioned, to the increasing specialization of management operations. The magnitude and complexity of large-scale business lead to the attempt to substitute group for individual responsibility and to a need for the exchange of opinion among specialists and for formal or informal organizations through which such exchange of opinion may crystallize into a group will. In this way, all aspects of a problem are carefully analyzed before decisive action is taken.

The results of these tendencies seem to be very much what we should expect—greater caution, frequently more red tape, but often also more rational handling of management problems and better co-ordination at the lower levels of authority. A partial corrective is found in committee action for the too narrow vision of functional specialists, but collective action also loses some of the dynamic quality that can characterize the decisions of the individual executive with adequate responsibility.[21] Committees of executives are likely to make

[21] Out of the committees of specialists may come constructive suggestions that might have occurred to no single individual in the absence of group discussion. In so far as this is the case, a committee may exercise a part of the initiating function that might otherwise have been lost.

fewer serious mistakes than single executives acting in their individual capacities, but they are also likely to make fewer brilliant decisions. In general, such group action interferes with clear-cut allocation of responsibility that supposedly characterizes better management organizations.

Despite these limitations of group decision-making, particularly on the formal plane, the committee system in management serves an important and useful function. In some companies, such as General Motors, it has apparently been a substantial success. Much depends on the choice of men, the kind of leadership provided, the manner in which responsibility is allocated, and similar factors. Properly organized and led, committees can provide an invaluable, though probably not a complete, antidote to the narrowness that comes from specialization.

THE CHIEF EXECUTIVE AS CO-ORDINATOR

With the diffusion of decision-making in the large firm, the chief executive must above all be a co-ordinator. While the foreman, the mill superintendent, or the sales manager may perform a co-ordinating function with respect to the particular segment of the enterprise over which he has jurisdiction, the co-ordination that we are interested in—that is a part of the leadership function—is the residual co-ordination that applies to the enterprise as a whole. This is exercised at the apex of the organizational pyramid. There must be some single authority (not necessarily a single individual) to establish objectives, to interpret subordinates' decisions in the light of these objectives, to reconcile internal conflicts, and generally to accept final responsibility for maintaining a smoothly running organization.

This function, despite the textbooks on management, is performed much more often by the chief executive than by the board of directors as a whole. The board or one of its committees may assume the co-ordinating role, but this is not typical. If the internal organization of the large corporation is pictured as a pyramid, the apex is reached ordinarily in the

man who is in fact the chief executive. The lines of authority branch out below him. Above him no further co-ordination is usually necessary. The board of directors or a committee of the board may *share* the co-ordinating role with the chief executive. This is not uncommon. But in the typical case of the relatively passive board, we do not find above the chief executive a superior, active, and independent co-ordinating authority.[22] Where, however, the board exercises an active approval function, even if only on certain types of matters, the chief executive's co-ordination is not final and complete. A residual element of co-ordination rests with the board (or perhaps a committee), though the chief executive may share in such final co-ordination through his membership in the group.[23]

Let us examine the co-ordinating activities of the chief executive in terms of the following functions: selection of top personnel and of the board of directors, maintenance and improvement of internal organization, maintaining and interpreting broad objectives through the use of his approval function, the exercise of personal leadership, and discovering and correcting defects in organization and policies throughout the enterprise.

Choice of personnel in the higher executive brackets is nearly always a function performed by the chief executive.

[22] How active or passive boards of directors are in the large corporation is considered at length in the next chapter.

[23] Since co-ordination includes the *possession* of authority, and since the board possesses an authority superior to that of the chief executive (even though it may not use it), one might say that the board always shares the co-ordinating role with the chief executive—the latter being the active co-ordinator, the board providing the passive co-ordination through its possession of final authority. (Stockholders may be excluded from consideration unless they have some means of making their authority effective; otherwise their authority is merely nominal.) The procedure we prefer—in the case of a passive board—is to consider the board's authority to have been shifted to the chief executive by default, or by management's control of the proxy machinery.

It might also be said that the chief executive exercises an active co-ordinating function *contiuously;* the board's co-ordinating role is ordinarily passive though it may become active sporadically (at which time final co-ordination shifts from the chief executive to the board).

He both initiates and approves. The board's approval may be necessary, but this is usually nominal. In a large merchandising concern, the internal reorganization instituted by a new chief executive involved as a principal element the selection of new major executives.[24] In American Telephone and Telegraph Company, selection of the chief executive officer of the subsidiary companies has apparently been the responsibility of the president of the parent company.[25] In the writer's conversations with top corporation executives, the latter have uniformly stressed the importance of the wise choice of chief subordinates as a significant element in effective business leadership.

Responsibility for executive personnel usually involves also determination of executive compensation. The need of maintaining an effective organization through the provision of adequate incentives makes the problem of executive compensation an intrinsic part of the co-ordination function. In some companies, the chief executive assumes sole responsibility for determining salaries, the nature of the bonus plan if one exists, and the allocation of the annual bonus fund among those participating.[26] In other cases, a special management committee or committee of the board assumes this function.

[24] See *Fortune*, January 1935, p. 76.

[25] FCC, *Investigation of the Telephone Industry in the United States*, p. 111. See also the same, pp. 111-14. An extract of a letter from President Gifford to Vice President Page in April 1930, reproduced in the same source, reads as follows: "Yesterday I asked Carter if he would come on and take Hall's job and he is thinking it over. I expect him to accept. If he does, I have decided to make Eide president of the Ohio Bell and Carroll president of the Indiana company." The same, p. 111.

[26] In one large company, the size of the total bonus and the terms of its allocation among the major executives were recommended to the board by the president. The board's approval was apparently nominal. For officers below the rank of vice president, the president determined compensation without approval by the board. The board determined the president's salary. (Information supplied by the company.) In a food products concern, the president fixed his own salary and that of the other major executives. (Information supplied by the company.) American Tobacco's well-publicized bonuses were determined by the president, G. W. Hill. See *Fortune*, December 1936, p. 97; *Time*, Mar. 11, 1940; *New York Times*, Feb. 11, 1933; and pamphlet issued to stockholders in 1933.

Where this is so, the chief executive is likely to play a leading role in arriving at the final compensation schedule.[27]

The chief executive may be responsible for selecting not only officers but also directors. Among large companies in which no particular outside interest group stands out as having great influence, it is more accurate to say that the chief executive (and his associates) choose the directors than that the directors choose the chief executive. Such companies are frequently spoken of as being "management controlled." This type of control, management's ability to choose directors, depends on the diffusion of stock ownership and the ability of management to control the proxy machinery. In a substantial number of the companies studied, the chief executive gave much thought to the make-up of his board of directors and actually exercised the final power of approval over the choice of directors.[28]

Numerous chief executives spend a great deal of time on the organizational aspects of the co-ordination problem. Involved here are the determination of the main lines of management organization and the establishing of procedures (reports, records, cost systems, and so forth) to ensure that

[27] In one company a committee of three major executives (but not including the chief executive) determined salaries. The chief executive was "consulted." Salaries of more than $25,000 went to the finance committee for (probably nominal) approval. (Information supplied by company.) In another company, a committee of certain members of the board, the president, and the chairman determined salaries. The latter two did not participate in fixing their own compensation. (Information supplied by company.) In one automobile company, the finance committee determined salaries (information supplied by company), but the initiation probably came from the two top men in management. In General Motors, a few years ago, bonus awards were made by "the Finance Committee on recommendation by the President of the Corporation" (Annual report, 1935). This was before the old finance committee was eliminated.

[28] The case of American Telephone and Telegraph has been frequently cited. (See FCC, *Investigation of the Telephone Industry in the United States*, pp. 97-100.) A similar situation was found in most of the other utilities studied, in several railroads, as well as in a number of industrials. Frequently if not usually, in the choice of directors, the chief executive worked closely with his advisers among both the executives and the directors. Frequently, also, he was more or less forced to give representation to particular groups—though not necessarily large individual stockholders.

delegation does not mean loss of contact among the various levels of the organization. The determination of the organizational framework involves the allocation of responsibility and authority among subordinates, decisions as to the use of committees, determination of the degree of specialization among executives and the means of securing adequate coordination among them, and so on. In short, the chief executive must offset the difficulties that arise from delegation by establishing the general lines of the framework within which delegation takes place.

One interesting example of a chief executive's emphasis on organization has been the work of Alfred Sloan in General Motors. The complex but apparently smoothly functioning organization in that company seems largely to have been due to him, with respect to initiation as well as approval. The changes which were formalized in 1937 were evidently at his initiation. These included the substitution of the present policy and administration committees for the former finance and executive committees of the board and the establishment of the present so-called policy groups. More fundamental than the establishment of these formal bodies has been the gradual evolution of a system of combining operating autonomy by the various product divisions with a system of centralized planning and financial control from the top. A good part of Sloan's time and effort during the 1920's, from the time he became president, was apparently devoted to devising a system of organization that would ensure effective and smooth operation of the automobile giant which had been put together by W. C. Durant.[29] Similarly, a large part of the activities of Myron Taylor and his successors in United

[29] A. P. Sloan, Jr., *Adventures of a White-Collar Man* (1941), pp. 134 ff.; *Fortune*, April 1938, p. 76, and December 1938, p. 41; and annual reports of the company for various years. Sloan undoubtedly worked with others, particularly Donaldson Brown, in mapping changes in organization, and some of the original initiation in the early twenties may have come from the du Ponts. In this connection, see, for example, *Fortune*, April 1938, p. 75.

States Steel Corporation seems to have been devoted to the problem of organization.[30]

The problem of creating (as distinct from maintaining) organization is particularly important in the case of a chief executive who has newly assumed his position. In addition to the work of Sloan and Taylor, numerous other illustrations might be cited, for example, the leadership of Zemurray in United Fruit, Davis in United States Rubber, Avery in Montgomery Ward, and H. M. Reed in American Radiator and Standard Sanitary. Also, when a chief executive contemplates retirement, he is likely to give much thought to problems of organization, to the creation of an organization that will aid his successor in carrying on (and probably, if his inner thoughts could be read, to providing a partial substitute for those qualities of leadership in himself which he believes his successor is not likely to have).

Continuous use of the general approval function is one of the most important means of effecting co-ordination. Decisions of subordinates may conflict. When this is so, the chief executive's approval function becomes a means of co-ordination. Similarly, the chief executive must act as a "Supreme Court" in the interpretation of the company's general policies and objectives. For this reason, decisions affecting matters of "general policy" usually go to the chief executive for approval. The role of the chief executive here includes not only the approval of decisions but also the determination of what is "general policy."

In discussing the chief executive's co-ordination through approval, what was said at an earlier point concerning the existence of group action in top management must be kept in mind. Final approval and co-ordination may be performed by two or more executives working together informally or as a formal management committee, by the chief executive in

[30] See *Fortune*, June 1936, pp. 113-14, and March 1940, pp. 64 ff.; *New York Times*, Dec. 9-10, 1937; Myron Taylor, *Ten Years of Steel* (address to stockholders at the 1938 annual meeting).

co-operation with a committee of the board, or by a committee of the board alone (with the chief executive acting merely as a member of the committee).[31] Since co-ordination is a composite function, its elements may be shared in various ways. Where such sharing exists in fact, some residual authority must exist in a single person or group. It usually rests (again we are speaking of the *de facto* situation) with the chief executive or with a committee of the board. Where a management committee is active in exercising some aspect of the co-ordination function, a residual authority rests with the man who is chief executive.

The element of personal leadership as a factor in co-ordination does not call for extended discussion. No chief executive can afford to ignore it. Emphasis on personal leadership constitutes recognition of what the economic theorist frequently ignores—that men, even profit-minded, "rational" executives in the higher ranks, are not in their economic activities merely thinking and working machines. Temperament, jealousies, and the insidious virus of "palace politics" can find their way into any organization of human beings: a labor union, a church, a university faculty, or a group of corporation executives. Personal leadership consists in good part of avoiding these personal frictions and of inspiring loyalty. When this function is not exercised effectively, the job of decision-making by both the chief executive and his subordinates suffers.[32]

One of the chief executive's important functions has thus far been only mentioned. In his capacity as a co-ordinator, he is also a "trouble-shooter." He must be able to see weaknesses in organization or in policies as they arise and to

[31] Apparently a very important co-ordinating function is performed by the executive committee of Standard Oil Company (New Jersey). See p. 104 above, and *Fortune*, June 1940, pp. 62-63.

[32] A management shake-up in a large oil company in 1933 seems in part, at least, to have been occasioned by personal frictions. In a prominent chemical company during the regime of a strong-willed chief executive, dismissal or resignation of important executives was a frequent occurrence. In a large merchandising concern, internal conflicts have led to a number of resignations in recent years.

suggest remedies. Like co-ordination in general, this is a job that is called for wherever there is organization. Both the foreman and the president are "trouble-shooters," but the chief executive's province is the enterprise as a whole. His function of discovering and diagnosing difficulties can best be included in this discussion of his role as a co-ordinator.[33] It could also be considered in connection with his role as an initiator of decisions.

The appointment of a new chief executive, particularly after a period of unsatisfactory profits, may mean a considerable period of "trouble-shooting" by the new appointee. Sometimes these cases involve temporary exercise of the co-ordinating function by an "outside control group." A strong minority interest or a banking group, for example, dissatisfied with the results of one man's leadership, may install a new chief executive to carry through whatever reorganization is necessary.

Even after the period of initial changes at the beginning of his tenure, the chief executive is ordinarily forced to continue his activities in recognizing difficulties and diagnosing their causes. Some part of this work can be and is normally delegated to subordinates in the higher brackets. Some of it is shared by a management committee. But the able and alert chief executive must take some responsibility here himself. In this capacity, the chief executive acts continuously both as partial initiator and as co-ordinator through continuous supervision of operating and financial results and through maintaining a flow of suggestions and recommendations from himself to subordinates. On occasion, even when a business is operating smoothly, this continuous process of diagnosis may lead to major changes in organization or personnel. In such cases, some of the detailed diagnosis as well as the actual prescribing of remedies is likely to be carried out by the chief executive.

[33] In view of the chief executive's position at the top of the management pyramid, his analysis and remedying of defects may run very largely in terms of organizational relationships and personnel. As such, it is automatically included in the co-ordinating function as we have defined it.

THE ROLE OF THE EXECUTIVE

Upon corporation officials, from the chief executive to subordinate officers such as the sales or production manager, has devolved primary responsibility for the exercise of business leadership in the modern large corporation. Although there are exceptions, the general rule is that corporate executives as a group determine the volume and direction of investment in their firms; they set prices and formulate price policies; and, in general, they make the other important decisions which constitute the heart of what many economists call the entrepreneurial function—the function which we have called business leadership. To say this is not to deny the existence of the varying degrees of influence exerted by interest groups, nor is it to imply that boards of directors uniformly serve in merely an ornamental capacity. But in general—for the range of large corporations covered in this study—the leadership role of the executive cannot be questioned.

At the head of the executive group stands the chief executive. He is the key figure in management. Below the chief executive, decision-making is diffused through the entire executive group. Particularly important are the men who stand at the vice presidents' level, just below that of the chief executive, but decisions of considerable significance for the firm as a whole may be at least initiated, and sometimes approved, by department heads and other subordinate officials.

The function that we have called business leadership cannot be dissociated from what corporation executives loosely think of as "management." With the increasing size and complexity of business and the consequent delegation of authority and responsibility, important parts of the composite function of decision-making come to be performed by men who not merely are not owners of their own businesses but are not even the executive heads. Particularly in such fields as the setting of individual prices, the control of production technique, and in similar operating problems, corporation officials in their capacities as more or less routine managers

initiate and, to a less extent, approve decisions important enough to enter into the leadership function.

We have not yet investigated the leadership activities of directors and of the important outside groups which may be in a position to participate in decision-making or otherwise influence management. This we shall do in subsequent chapters. The findings of those chapters, however, will only add detail to and modify on particular points the implications of the preceding analysis. Of all the groups connected with the large corporation, the executive group far more than any other has come to perform the leadership function. Some of the broader implications of this fact will be discussed in our final chapter.

CHAPTER VI

THE BOARD OF DIRECTORS

In the broader of the two senses in which the word is used, "management" includes not merely the executives but also the board of directors. The board stands between the stockholders and the executive group. It is not expected even in theory to direct the affairs of a business in any detail, but it *is* supposed to exercise a broad supervision. This broad supervision presumably includes several types of activities: choice of the major executives (or at least the chief executive), establishment of general objectives, formulation of broad policies, a general appraisal of the operating and financial results of the firm's activities, and distribution of profits.[1] The chief executive reports to the board, and the board reports to the stockholders and—though its responsibilities here are very nebulous—to the community at large.

This picture of the board's place in corporate organization implies that directors as a group share with the executives in the exercise of active leadership. Such leadership by the board would include some initiation, approval or veto of the major decisions made by the chief executive, and some part of the co-ordination function.

It is no secret of course that the board's actual role in most large corporations is far different from the conventionalized picture given in the preceding paragraphs. The extent to which boards of directors have become inactive is indicated in part by the dissatisfaction expressed in many quarters with the role which the typical board now plays in the operations

[1] According to McKinsey, the functions of the board of directors should include: being responsible for establishing general objectives and major policies, determining the structure of organization and selecting major executives, and being responsible for general supervision of the activities of executives. J. O. McKinsey in W. J. Donald, ed., *Handbook of Business Administration* (1931), p. 392. See also G. E. Bates, "The Board of Directors," *Harvard Business Review*, Vol. 19 (1940), pp. 74-76; and P. E. Holden and others, *Top-Management Organization and Control*, p. 17.

of the large corporation. Does this mean that directors do not contribute to the job of leadership which needs to be done in the large firm? The answer is to be found in the organization and activities of the board, to a study of which we now turn.

SIZE AND COMPOSITION OF BOARDS

Among very large corporations, boards of directors vary as to size and as to the proportion made up of working executives. The table below, covering the 155 giant corporations

SIZE OF BOARDS OF DIRECTORS IN 155 LARGE CORPORATIONS IN 1935[a]

Number of Men on Board	Number of Companies			
	Industrials	Public Utilities	Railroads	Total
6	2	2	—	4
7– 8	3	4	2	9
9–10	16	7	3	26
11–12	22	4	9	35
13–14	10	8	7	25
15–16	12	4	11	27
17–18	9	3	3	15
19–20	3	1	—	4
21 and over	7	2	1	10
Total	84	35	36	155
Average[b] (number of men)	13.9	12.6	13.4	13.5

[a] Based on annual reports and Poor's and Moody's investment manuals. In a few cases, data for 1936 were used.
[b] Arithmetic mean.

mentioned in Chapter II (p. 24), indicates the extent of the variation in size at the end of 1935. Four companies had boards of as few as six men. At the other extreme, both du Pont and General Motors in 1935 had boards of at least 35 men, and, in all, 10 companies had boards of more than 20 men. The average (arithmetic mean) for all 155 companies was 13.5 men per board, and this seems to represent a reasonably typical figure.[2] Groups much larger than this are

[2] The median was 13 men per board. Eighty-seven companies, 56 per cent of the total, had boards of between 11 and 16 men.

apt to be unwieldy and ineffective. Though no general rule can be laid down, a somewhat smaller board, say six to twelve men, is likely to be more effective as a working group and yet large enough to give the diversity of background and viewpoint which should characterize a good board.[3]

The table on page 117 does not reveal any striking contrasts in the size of boards found among the three groups, industrials, rails, and utilities. The average ranges from 12.6 for the utilities to 13.9 for the industrials. Very small and very large boards are less common among the railroads than among the other two groups.[4] The six largest boards, ranging from 24 to 36 men, were all those of industrial companies.[5]

The composition of these boards of directors is more significant than their size. Of particular importance is the extent to which the board in the large corporation has come to be made up of salaried executives. How far this tendency has gone is indicated in the table on page 119. Executives constituted at least 50 per cent of the board in 35 of the 155 giants.[6] This phenomenon is most prevalent by far among

[3] A board of from 5 to 12 members is suggested by Bates, in *Harvard Business Review*, Vol. 19, p. 86.

[4] Twenty-seven railroads, three quarters of the total, had boards of not less than 11 and not more than 16 men. Fifty-two per cent of the industrial boards and 46 per cent of the utility boards fell in this range.

[5] The National Industrial Conference Board has made a study of the size of boards in 505 small and large companies, some with assets of 1 million dollars or less. (Our analysis applies only to companies with assets of at least 50 million dollars.) Banking and insurance companies, omitted from the present study, were included. The Conference Board found boards of 20 men or over more prevalent among non-manufacturing than among manufacturing companies. The former group, however, included not only rails and utilities but also some industrial companies (in mining, service, and trade) and, most important for this purpose, banks and insurance companies. It is among the last two groups that large boards are most common. See National Industrial Conference Board, *Prevailing Practices Regarding Corporation Directors*, Studies in Administrative Control No. 2 (1939), p. 7. For other studies of the size of boards, see Holden and others, *Top-Management Organization and Control*, pp. 219-20; also Bates, *Harvard Business Review*, Vol. 19, p. 86.

[6] In four companies, all direct descendants of the old Standard Oil Trust, the board was made up entirely of officers. In the Conference Board study, 32 out of 108 corporations with assets of 50 millions or more reported that at least half of their boards were made up of officers. This was true in 21 of 34 manufacturing companies but in only 11 of 74 non-manufactur-

the industrial companies. It occurs occasionally in the utilities and never among the large railroads.[7] Even when the executive group is in the minority, it is still likely—particularly among the industrial companies—to make up a substantial

OFFICERS' REPRESENTATION ON THE BOARDS OF DIRECTORS OF 155 LARGE CORPORATIONS IN 1935[a]

Percentage of Board Composed of Officers[b]	Number of Companies			
	Industrials	Public Utilities	Railroads	Total
0– 25	17	13	19	49
25– 50	37	17	17	71
50– 75	20[c]	2[d]	—	22
75–100	10[e]	3	—	13
Total	84	35	36	155
Average (per cent)[f]	43.1	32.7	21.4	35.9

[a] From annual reports and Poor's and Moody's investment manuals. In a few cases data for 1936 were used. Included as officers are all men stated to be officers in the annual report, including the chairman of the board and the chairman of the executive or finance committee. Officers of subsidiaries on the board of the parent company were counted as officers, even though not included in its list of executives by the parent company. This was done where lists of officers of subsidiaries were given. Probably some executives of subsidiaries were missed, particularly among the utilities, but the degree of error on this account is certainly not large.

[b] Lower limit of class interval inclusive, except for the interval 75–100, for which both upper and lower limits are inclusive.

[c] Includes three cases in which officers made up exactly 50 per cent of the board.

[d] Includes one case in which officers made up exactly 50 per cent of the board.

[e] Includes four boards made up completely of executives.

[f] Obtained by dividing the total number of officer-members by the total number of directors in each industrial grouping.

fraction of the total. In 67 out of 84 industrials, for example, executives accounted for 25 per cent or more of the total board membership. This was true also in 22 of the 35 public utilities but in less than half of the railroads.[8]

ing corporations. *Prevailing Practices Regarding Corporation Directors*, p. 12.

[7] See TNEC Monograph No. 11, p. 24.

[8] Of the 37 industrials in which officers constituted at least 25 per cent but not as much as 50 per cent of the total membership, there were 15 cases in which the substitution of one additional executive for an outside director would have brought the officers' fraction up to 50 per cent or more of the board.

To the extent that executives predominate on the board, directors have ceased to make up a body independent of and superior to the executive group. The implications of this development have not received the attention they deserve.[9]

The fact that executives make up a large fraction of the total board assumes great significance when management has become separated from ownership. If the executive group holds a majority of the stock, the fact that officers predominate on the board does not of itself prejudice the interests of any group. The officer-directors, whether as officers or as directors, represent the majority stockholders. When the great bulk of stock ownership is divorced from management, however, a board made up primarily of officers creates an entirely different situation. In this case, the officers are given the right to supervise themselves;[10] there is no continuous independent link between management and stockholders; and the interests of the latter can be protected, except as management chooses to protect them, only through the medium of the annual stockholders' meetings and through resort to legal action by particular stockholders. The weakness of the protection provided by these two media needs no elaboration. Thus, in effect, the officer board means that the board as an independent supervisory body has ceased to exist.[11]

While the officer board, taken in conjunction with the separation of ownership and management, represents a sig-

[9] See, however, TNEC Monograph No. 11, pp. 124-25; National Industrial Conference Board, *Prevailing Practices Regarding Corporation Directors*, p. 12; Bates, *Harvard Business Review*, Vol. 19, pp. 77-80.

[10] Referring to the board made up entirely of officers, the National Industrial Conference Board has aptly put the case thus: "The board members sitting as directors are merely approving the action of the board members in their executive capacities, a procedure that is faintly reminiscent of Pooh Bah's strategems in *The Mikado*." (*Prevailing Practices Regarding Corporation Directors*, p. 12.) The same characterization can be applied to the case in which officers constitute a majority, not necessarily all, of the board.

[11] See Bates, *Harvard Business Review*, Vol. 19, p. 79. For certain other disadvantages of the officer board, see also TNEC Monograph No. 11, p. 37; and Holden and others, *Top-Management Organization and Control*, p. 221.

nificant development,[12] its importance should not be overstressed. In the first place, officers *may*, despite their lack of ownership, take their responsibilities to stockholders quite seriously. In addition, the executive group is in a better position to recognize and protect the interests of other groups —for example, workers or customers—than are directors elected by and owing allegiance to particular stockholding and other interests. How seriously officers take their responsibilities in these directions is, of course, a moot point. Some broadening of their sense of responsibility in recent years has certainly occurred, and in the last few years chief executives have paid a good deal of lip service, at least, not only to their stockholders but also to labor and the public.

Executives need all the sense of responsibility they can muster, because the prevalence of officer boards by no means indicates the full extent to which the board of directors fails to function as an active supervisory body independent of and superior to the executive group. In fact, boards are not generally picked by stockholders in the large corporations we are considering. Some directors are placed on boards at the insistence of non-stockholding groups, for example, bankers. Of greater importance, it is more common for executives to select directors than vice versa. Management may choose—or occasionally be forced to select—men who will represent particular stockholding or other strong interest groups. The crucial point, however, is that the executives themselves usually nominate the slate of directors on whom the stockholders vote and then, through the proxy machinery, secure the election of their own candidates. It is conceivable that such management-selected boards might exercise an independent veto over the decisions of executives. But this method of selection, added to the fact that directors for other reasons have volun-

[12] The development, in the sense of something that has changed, is more in the direction of the growing separation of ownership and management than of marked tendency for officers to constitute larger fractions of the board. Officer boards are not new, but a new situation is created as soon as officers are no longer the principal owners.

tarily yielded their functions to executives, means that in practice even the board on which only one or two officers serve is likely not to exercise a real and continuing control over the executive group. This situation has been called "management control."

It is not to be implied from this discussion that in all large corporations the executive group selects and then dominates its board of directors. Nor is it to be implied that, in choosing new directors, the chief executive and his associates act independently of the directors currently serving or of large stockholders, bankers, and other interest groups. The advice sought from and the consideration given to these groups vary. Nonetheless, the power and activities of the executive

COMPOSITION OF THE BOARDS OF DIRECTORS OF 35 SELECTED LARGE CORPORATIONS IN 1935[a]

INDUSTRIALS

Company	Officers[b]	Commercial Bankers[c]	Investment Bankers[d]	Important Stockholders[e]	Miscellaneous[f]	Total
1.....	6	2	—	2 (1)	2	12
2.....	7 (1)	—	2	3 (2)	1	13
3.....	5 (3)	—	—	2 (2)	2	9
4.....	4	3	1	7	—	15
5.....	4	1	1	3 (2)	3	12
6.....	4 (1)	3	2	2	5	16
7.....	10 (1)	—	—	5	4	19
8.....	5	1	—	7	2	15
9.....	5	—	3	3 (2)	1	12
10.....	4	1	3	—	7	15
11.....	11	8	—	2 (1)	3	24
12.....	7	2	5	1	3	18
13.....	9	—	1	2	3	15
14.....	8	1	—	2	3	14
15.....	18 (2)	4	2	7 (5)	4	35
16.....	6	—	2	—	—	8
17.....	11	—	1	1	2	15
18.....	7	1	2	3	4	17
19.....	10 (4)	—	—	5	—	15
20.....	10	—	—	—	—	10
21.....	9	1	1	—	1	12
22.....	15 (3)	—	—	2 (2)	—	17
23.....	8	—	—	3 (2)	—	11
24.....	4 (2)	1	1	3 (3)	4	13
25.....	4	—	—	4 (3)	2	10
Total.......	191	29	27	69	56	372

COMPOSITION OF BOARDS OF DIRECTORS—*Continued*

PUBLIC UTILITIES

Company	Officers[b]	Commercial Bankers[c]	Investment Bankers[d]	Important Stockholders[e]	Miscellaneous[f]	Total
1.....	3	3	2	1	4	13
2.....	4	4	—	6 (2)	—	14
3.....	4	3	1	1	9	18
4.....	8 (1)	—	1	1	2	12
5.....	3	4	—	2	10	19
Total.......	22	14	4	11	25	76

RAILROADS

Company	Officers[b]	Commercial Bankers[c]	Investment Bankers[d]	Important Stockholders[e]	Miscellaneous[f]	Total
1.....	3	—	1	2	6	12
2.....	1	2	1	6	11	21
3.....	1	4	—	5(3)	5	15
4.....	5	2	3	4	1	15
5.....	3	—	2	2	8	15
Total.......	13	8	7	19	31	78
Total, all companies.	226	51	38	99	112	526

[a] Based on information in annual reports, various types of biographical data, numerous miscellaneous sources, and, most important, interviews with officials of the companies studied. For the nature of the sample, see pp. 60-61.

[b] Does not include retired executives. Figures in parentheses give the number of officer-directors who were members of the dominant stockholding group. See p. 124.

[c] Includes officers but not directors of commercial banks.

[d] Includes officers and partners of investment banking and brokerage houses.

[e] Includes all directors known to be on the board because of substantial stockholdings. Figures in parentheses indicate the number of these who belonged to the dominant stockholding group, if one existed.

[f] Includes former officers, customers, outside legal counsel, local businessmen and capitalists, and others chosen for their prestige value or contacts or for similar reasons. See pp. 125-126.

group indicate rather clearly that the failure of the board to serve in a vigorous and independent capacity is not measured simply by the number of officer boards we can find among these large corporations.

A more detailed tabulation of the composition of the boards of a selected small group of giant corporations is given on pages 122-23. The 35 firms listed there form a more or less representative sample of those companies studied for which

relatively complete information concerning directors was available, but the group should be considered as indicating the various types of situations found in practice rather than as a completely representative sample of all very large corporations.[13]

For all 35 companies together, officers constituted the largest single group on the board. In the 25 industrials, officers actually totaled a slight majority of all directors. Next to officers, large stockholders or representatives of important stockholding interests formed the largest single group. There was at least one commercial or investment banker on the great majority of these boards. For all 35 companies, there were on the average about 2.5 bankers per board.[14] Commercial bankers outnumbered members of the investment banking group. One important fact about the representatives of commercial banks needs to be stressed. A good many of them serve on boards not because they are bankers but because their institutions represent trusts or estates holding large blocks of stock in the companies. This was true, for example, of most of the commercial bankers on the boards of the fourth and eleventh companies in the list of industrials. The latter had eight officers of commercial banks on its board.

Important stockholdings are also represented in the officers' group. It will be noted that in a number of companies in the table on page 122, a figure in parentheses appears after the number of officers on the board. This figure gives the number of men, already included among the officer-directors, who are members of the group known to have the largest stockholding interest in the company.[15] Membership of such men

[13] A study of the composition of the boards of directors in 31 giant industrials is presented in Holden and others, *Top-Management Organization and Control*, p. 220. The total number of directors were classed as follows: active officers, 42 per cent; former officers, 7 per cent; representing substantial ownership, 19 per cent; outsiders, 32 per cent.

[14] An individual was not considered to be a banker merely because he served on the board of a bank. The term is here confined to officers and partners of banking institutions.

[15] Only officers who are actual members of the dominant stockholding group are included in the figure in parentheses. Other executives may have

on the board was found in eight of the industrials but in only one of the utilities and in none of the railroads in the sample of 35 companies.

After the figure for stockholder-directors, similarly, is another item in parentheses, giving the number of such directors who are members of the group known to represent the dominant stockholding interest in the company. Thus in the first company listed, two members of the board represented important stockholdings, but one of these was a member of one of the two families who together owned much the largest fraction of the company's stock. Representation on the board of such large minority holdings occurred in 13 of the 35 companies. This does not include the few cases in which the dominant stockholding group was represented among the officers but not among the outside directors.

REASONS FOR SELECTING DIRECTORS

Thus far we have been dealing with the question: Who are directors? A related but different question is: Why are these men chosen as directors? A banker may be asked to serve to give representation to a particular banking interest or merely because his financial advice is sought. Commercial bankers may be on the board for several reasons: because a bank is an important creditor, to give representation to stock for which the bank acts as trustee, because the commercial banker is considered a good source of financial advice, or to provide a contact to facilitate later securing of loans. Similarly a stockholder may be asked to serve not primarily because he is a stockholder but because his advice and judgment are desired.

These considerations are particularly important in connection with the miscellaneous group of directors in the table on page 122. The men in this group represent a variety of busi-

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been substantial stockholders in their own right but yet were not members of the group having the largest minority holdings. In all cases, the officers included in the figure in parentheses were members of the family or closely connected with the company owning the dominant stockholding interest.

ness, and some non-business, interests. Any significant classification of these men must take into account the reasons they were asked to serve on the boards of the companies.

Among the industrials in the sample of 35 companies whose boards we have been considering, the miscellaneous group of directors is not particularly large. It includes chiefly local businessmen and capitalists, outside legal counsel, a few representatives of insurance companies, retired officers, and a variety of prominent businessmen chosen for their prestige value or for their contacts and advice—but very few customers. The miscellaneous group is relatively larger among the public utilities and railroads, because these enterprises characteristically place more emphasis, in selecting directors, on outside contacts, public relations, and (in the case of the railroads) traffic problems. The board of a large operating utility, for example, is ordinarily well sprinkled with men chosen to represent various elements in the community, and the same is true to a less extent of the railroads. The latter, to a greater degree than the industrials or utilities, are likely to pick some of their directors from among their more important customers—that is, for traffic reasons.

In a recent survey of some 500 corporations in all fields, ranging in size from those with assets of less than 1 million to those as large as the concerns we have been studying, the National Industrial Conference Board obtained the reasons given in the table on page 127 for including directors.[16]

Taking these reasons at their face value, a rough classification indicates that approximately two thirds of the directors

[16] The Conference Board states: "In the Conference Board's original questionnaire it was requested that the single predominant reason for inclusion of an individual be checked. Many companies, however, stated that it was impossible to follow this procedure because several reasons for such inclusion had to be given almost equal weight.

"As a result of this difficulty, only those replies which seemed most precise were tabulated in Table 13 [the table reproduced here]. It was felt, however, that the total replies would also be of interest, and these are tabulated in Table 14 [which we have not reproduced]. The importance of the first three groups does not change materially when this basis of tabulation is adopted." National Industrial Conference Board, *Prevailing Practices Regarding Corporation Directors*, p. 14.

covered were chosen because of their supposed knowledge, ability, and judgment, and one third to give representation to particular groups. The first reason cited in the table, knowledge of technical details, refers chiefly to officer-directors; and these men, obviously, are also chosen because

REASONS FOR INCLUSION OF INDIVIDUAL DIRECTORS[a]
(Tabulation of Replies Giving One Reason per Director)

Reason	Number of Directors		
	Manufacturing Companies	Non-Manufacturing Companies	All Companies
Knowledge of technical details of business	527	145	672
Sound executive judgment	350	169	519
Important stockholder	170	59	229
Represents important stockholdings	238	92	330
Represents banks or financial interests	49	24	73
Financial counsel	99	49	148
Marketing counsel	45	6	51
Legal counsel	116	52	168
Knowledge of external business conditions	57	76	133
Knowledge of labor relations	8	5	13
Knowledge of foreign markets	11	1	12
Represents customers or brings business	29	18	47
Represents allied manufacturing or commercial interest	27	17	44
Retired or former official of company	78	24	102
Executive officer	30	7	37
Other reasons	34	13	47
Total	1,868	757	2,625

[a] Reproduced by permission from National Industrial Conference Board, *Prevailing Practices Regarding Corporation Directors*, Studies in Administrative Control No. 2, p. 13.

they represent a particular interest, namely, that of management itself.

In general, executives tend to minimize those reasons for choosing directors which are based on the need for giving representation to special interest groups and to stress those which center around securing good advice.[17] They do this for two reasons. First, they consider it to be "poor public

[17] Therefore it is not unreasonable to suspect that the replies given to the Conference Board's question on this point may be biased somewhat in the direction of minimizing reasons based on giving representation to particular groups.

relations" to give the impression that their company is influenced or "controlled" by some outside group; above all, management resents the implications of "banker control." Secondly, the executive group looks upon the board's proper function as being one primarily of advice, not of control over executives and limitation of the latter's authority. Stockholders and other groups may want representation to protect their interests, and at least the stockholders have some legal protection in securing representation for this reason. Top management, however, looks upon the proper function of the board as that of serving as a super-staff of financial and general business advisers. We shall have occasion to refer to this important point again.[18]

ACTIVE LEADERSHIP BY BOARDS OF DIRECTORS

As we saw in Chapters IV and V, executives rather than directors make the bulk of decisions which enter into the leadership function in the large corporation. This is particularly true of initiation. Origination and formulation of proposals almost invariably come from the executive group, and directors, in so far as they participate at all in the decision-making function, do so through their power to veto or approve decisions laid before them by the chief executive. By virtue of this fact, the creative and dynamic elements of business leadership cannot be expected to develop out of the deliberations and activities of the board as a formal group.

In the broad range of non-financial matters—in the fields of prices, marketing, production techniques, new products, labor—there was little or no indication of initiation coming from the boards of any of the large companies studied. This was equally true of the industrials, the utilities, and the railroads. It was true of initiation with respect to both "broad policies" and decisions on specific matters.

This much, perhaps, is to be expected. But absence of initiation by the board holds today in the large corporation even for major financial matters, including investment policy

[18] See the concluding section of this chapter and pp. 343-51.

and expansion programs. However real in some cases may be the board's veto power over the chief executive's recommendations in these fields, the initiation—seeing the need for action and formulation of a plan—comes from the executive group, even on the broadest financial questions.

On a few matters the board or one of its committees may occasionally or regularly initiate decisions. In some cases, the board initiates as well as approves the decision leading to the selection of a new chief executive. This, however, is not typical. In the great majority of the companies for which information was available on this point, initiation with respect to the choice of a new president or chairman came from one or more of the following sources: the preceding chief executive, a few individual directors acting informally,[19] or from individuals or groups outside of management entirely, for example, large stockholders or bankers.[20] Of these, the first is probably the most common; the chief executive picks his own successor, subject to the more or less active approval of the board.[21]

[19] For example, in each of two prominent operating utilities the present chief executive was selected by a small but important group of influential directors. The choice in each case was later ratified by the board as a whole. The key directors in one of the two companies represented large stockholdings. In an industrial company, a former chief executive was apparently selected by directors who represented an important banking group with which the company was frequently associated.

[20] These outside groups may or may not be represented on the board. The man now at the head of a large rubber company was apparently chosen by the present dominant stockholding group after the latter acquired control. In another case, the largest stockholder selected himself as the new chief executive when he became dissatisfied with the existing management. A number of cases of banker selection of chief executives, particularly after mergers and reorganizations, could be mentioned. See, for example, H. and R. Wolf, *Rubber*, pp. 454-55; Ida M. Tarbell, *Life of Elbert H. Gary*, p. 94; *Fortune*, January 1935, pp. 70-71.

[21] The well publicized case of the American Telephone and Telegraph Company is probably the best-known example. See Federal Communications Commission, *Investigation of the Telephone Industry in the United States*, H. Doc. 340, 76 Cong., 1 sess., pp. 100-01. Many other examples could also be mentioned. The present heads of each of the following companies were apparently picked by their predecessors: one of the "big three" automobile companies, a building materials concern, one of the largest steel companies, and a public utility holding company. For other

The board may also initiate action with respect to the chief executive's compensation. This may be done by the board as a whole, by an executive or finance committee, or by a special salary committee.[22] Salaries of other major executives and awards under bonus plans may need approval of the board, but initiation is usually from the chief executive or a committee of senior officers. Even the chief executive's salary may not be determined by the board.[23]

In the choice of new directors, the board may participate in the selection of candidates to be submitted to the stockholders, but here again active initiation is more likely to come from the chief executive, individual directors who are close to the chief executive (perhaps the executive or finance committee as a whole), and from outside interest groups.[24] Approval of such selections usually rests with those in management in control of the proxy machinery; executives, particularly the chief executive, are more important than the board as a formal group.

Dividend decisions may also be initiated by the board, although this is not the normal procedure. In some cases, the

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examples, see *Fortune*, January 1937, pp. 57-58, and *New York Times*, Apr. 12, 1939; *Fortune*, October 1939, p. 150; the same, January 1940, p. 101. For an interesting example of a chief executive's choosing his successor in a prominent railroad, see *Investigation of Railroads, Holding Companies, and Affiliated Companies*, Hearings before a Subcommittee of the Senate Committee on Interstate Commerce, Pt. 18, 75 Cong. 2 sess., p. 7962.

[22] Examples of each of these situations may be mentioned. In a manufacturing concern and a public utility, the board as a whole set the chief executive's salary. In an automobile company, the finance committee determined the chief executive's compensation. In an oil company, a special committee of the board fixed the chief executive's and other top salaries. (Information supplied by the companies mentioned.)

[23] In at least three companies studied, the evidence was clear that the chief executive set his own salary, as well as that of his major officers, subject to formal ratification of the board. Undoubtedly, other cases also existed.

[24] The most common situation is for the chief executive to pick new candidates for the board, usually with the advice of fellow officers or of a few directors whose judgment he particularly values. See, for example, FCC, *Investigation of the Telephone Industry in the United States*, pp. 97-100, for the procedure in American Telephone and Telegraph, a method which is repeated in many other companies.

chief executive himself suggests the dividend to be declared; in others, an executive or finance committee initiates the dividend decision. In all cases, formal ratification by the board is necessary, though in some companies such approval is largely nominal.[25]

When a company is experiencing difficulties, the board may undertake some active initiation in an attempt to diagnose the trouble and prescribe remedies. Recently, in one large company, the directors took decisive action leading to the selection of a new chief executive and to important changes in some of the company's policies.[26] A few years ago, in a prominent railroad company, a decline in earnings led the board to undertake an intensive survey of the company's organization and operations.[27] Other examples of spasmodic initiation, even by ordinarily passive boards, are occasionally encountered.

The board's approval function is more important than its initiating activities. But even with respect to approval, many boards in these large companies are almost completely passive.[28] In such cases, the final approval function is exercised by the chief executive and his top officers, perhaps an executive or finance committee of the board, or jointly by the chief executive and a few influential directors acting as his informal advisers.

For the majority of the corporations studied, the available evidence strongly suggests that ratification of management proposals by the board is largely a formality. The great majority of executives interviewed stated or implied that their boards were "passive" or that approval of management recommendations was "nominal" or "automatic." Sometimes the word "generally" was added in qualification. In no more

[25] For examples of procedures in the making and approving of dividend recommendations, see p. 94, above.

[26] See *Fortune*, March 1940, p. 154.

[27] Information supplied by the company. For another example of increasing activity by a board of directors when trouble developed, see Committee on Interstate Commerce, *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. 25, Pt. 22, 76 Cong. 3 sess., pp. 19, 23, 28.

[28] See TNEC Monograph No. 11, pp. 23-25.

than a fifth of the companies for which evidence was available was the board definitely stated to exercise an active approval function. In a few cases, the evidence was conflicting, the implications usually being that the board occasionally but not regularly did exercise a real control over management recommendations.[29]

The tendency for directors to exercise only nominal approval arises in part from their failure to attend board meetings.[30] Of some importance also is the failure of many boards to meet often enough.[31] Far more important, however, are the various factors responsible for a disinclination or inability of directors to act effectively when they do meet.

Real approval by the board is most likely to be exercised with respect to financial decisions, particularly in such matters as large capital expenditures, new security issues, and declaration of dividends.[32] In the majority of cases, however,

[29] These generalizations are based on a study of 32 companies for which information available, obtained almost exclusively from interviews, permitted an evaluation to be made of the board's general use of its approval powers.

[30] In 100 corporations with assets of 50 million dollars or more investigated by the National Industrial Conference Board, 272 out of 1349 directors had a perfect attendance record in 1938, and 1106 attended half or more of the board meetings held during the year. It may be suspected that most of the 272 were officers who had merely to take the elevator to reach the board room. Only 656 directors, 49 per cent of the total, attended as many as four meetings out of five. The implication again is that "outside" directors were not too faithful in their attendance. (See *Prevailing Practices Regarding Corporation Directors*, p. 15.) The Conference Board's figures also indicate that good attendance declines with the increase in size of the corporation.

[31] Of 111 giant corporations reporting to the Conference Board on this point, in 91 the board met as often as eight times a year. In 48 cases, the board met more often than once a month. *Prevailing Practices Regarding Corporation Directors*, p. 15.)

[32] In some cases, even an ordinarily passive board may occasionally exercise an active veto over decisions on these matters. The generally passive board of an operating utility, some years ago, refused to accept a dividend recommendation of the president. In another company, management's plans for a new security issue were held up by wrangling on the board concerning the relative participation of certain banking houses in the underwriting of the proposed issue. For another example of the board's playing an active approval role, in this case in the Pennsylvania Railroad, see *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. 1182, Pt. 3, 76 Cong. 3 sess.

approval on these matters is not likely to represent independent decision-making by the board.[33] Even the active board is not apt to deliberate at length over operating policies, most of which may not be submitted to the board at all or which may come before it only in the form of budgets or of operating statements showing the results of policies previously put into effect by the executive group.

On crucial non-financial matters, the board may occasionally play a positive role.[34] We have already mentioned certain types of decisions which the board is most likely to initiate. On these matters, even the ordinarily passive board *may* exercise a real approval function, though initiation may have come from the chief executive, a committee of the board, or a few influential directors working informally.

What has been said of the typical board's initiating and approval role indicates also that the board in most large corporations does not ordinarily provide the final co-ordination that any large enterprise needs. At every regular board meeting, directors are normally supplied with reports and summaries indicating the results of recent operations and the current and prospective financial position of the company. In addition, important special situations are usually brought to

[33] In several companies, to take the case of dividends, the final approving body was said to be the executive or finance committee. In several other companies, it was definitely stated that "management, not the board," sets the dividend. In yet another case, the writer was informed that "the chairman determines the dividend, but the board is free in expressing its opinions." (All information obtained from officials in the various companies concerned.) For evidence on the inactive role of some railroad boards, even in financial affairs, see Interstate Commerce Commission, *46th Annual Report*, 1932, p. 28; also Securities and Exchange Commission, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Pt. 2, pp. 33 ff.; and *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. 25, various parts.

[34] During a crucial and protracted strike in one large company which involved a fundamental change in the company's labor policy, the board did not meet once during the period of negotiations. (Information supplied by the company.) On the other hand, Myron Taylor called a special meeting of the board of United States Steel to approve the proposed recognition of the SWOC (*Ten Years of Steel*, p. 42). Such approval was in all probability largely nominal. Other cases might be cited in which the board's approval in such matters has not been nominal.

the board's attention. Careful scrutiny and evaluation of this information by a capable director familiar with the firm's affairs should provide the basis for active participation in the co-ordinating function. In practice, the careful scrutiny is frequently lacking; the necessary familiarity with the internal workings of the company is absent; and the board frequently voluntarily yields to the chief executive the authority it is supposed to possess—partly because of an unwillingness to assume responsibility or to devote the necessary time, partly, in many cases, because the directors owe their positions to the executive group which they are themselves supposed to supervise. Even the active board, however, is likely to find that its residual co-ordinating function is limited. Because of the delegation of authority and the functional specialization within management, final co-ordination of many aspects of the company's operations must be left to the chief executive and perhaps a general management committee.[35]

In general, for these large corporations, we cannot avoid the conclusion that the board as a formal body plays only a restricted role in the decision-making and co-ordination that constitute business leadership. This conclusion holds for the great majority of very large firms, regardless of the proportion of the board composed of operating officials. If we take into account further that in a number of cases even the active board is likely to be dominated by officer-directors who constitute a large minority or indeed even a majority of the board, the conclusion that the board does not typically serve to any marked extent as *an active and independent* participant in the leadership function holds with even greater force.

[35] Where the board is active, but its co-ordinating function is thus limited, the situation resulting may be described equally well in either of two ways. We may say that, despite its superior authority, the board really shares the final co-ordinating function with the chief executive, or that the board alone exercises it. In the latter case, the co-ordinating function covers a narrower range of activities and can be said to include the co-ordinating work of the chief executive only through the board's ability to hire and fire the chief executive at will. The ability of even an active and powerful board to do this, however, is likely to be limited except in extreme circumstances.

THE INFLUENTIAL DIRECTOR

This emphasis on the passivity of the board as a whole must not lead us to minimize the important role which is frequently played by individual directors. In many large companies, perhaps in most, individual members of the board act as trusted counselors of the chief executive and frequently are able to exert a strong influence on him. Often these influential directors owe their strategic position to powerful interest groups that they represent on the board, but this is by no means always the case. The influence of the director may be traced to numerous other factors—for example, personal friendship with the chief executive, a strong personality, or the value placed on his judgment and ability by the president or chairman.

These influential non-officer directors, where they exist, seldom number more than a small fraction of the total board. There may be from one to three, occasionally more, in a single corporation. Their influence is exerted informally—outside of rather than in board meetings. Their advice and suggestions are as a rule continuously available to the chief executive via the telephone, and the luncheon table provides another setting for their activities. They are likely to be consulted by the chief executive in the few days preceding a board meeting. At this time, important matters to be brought before the board may be discussed, and the weight of these particular directors' opinions may have an important effect upon the form in which the proposals are submitted to the board. In some cases, the dividend to be recommended to the board at its forthcoming meeting will also be decided at informal conferences. The influential directors may participate with the chief executive in choosing new directors, and they may, on occasion, form the group actually responsible for the choice of a new executive.[36] While they are not likely

[36] See p. 129, above. If the chief executive chooses his successor in advance, this inner group of advisers may approve the selection made, later ratification by the board being nominal. If the chief executive retires or dies without

to be consulted on many types of operating decisions, their counsel may very well be sought on important labor problems, changes in marketing and price policy, and similar matters of strategic significance. The chief executive is even more likely to seek their opinions on important financial decisions.[37]

It is not easy to summarize and evaluate the role played by individual directors in these cases. Many chief executives would say simply that these men are trusted advisers, whose counsel is followed because (and only in so far as) the chief executive respects their judgment. In many cases, such a characterization represents an accurate appraisal. Even in those cases, however, the question remains: To what extent does this "advice" represent the exercise of some part of the leadership function? There is no unmistakable line of demarcation between advice or suggestions and the actual initiation or approval of decisions. The greater the weight placed upon the opinions of these men, the more their advice amounts to a final veto or approval of matters submitted to them by the chief executive. Where their influence stems from the strength of an outside interest group—a large stockholding interest or a prominent banking house, for example—their advice and suggestions are even more clearly tantamount to final veto or approval. It seems reasonable to conclude that

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having chosen his successor, the inner group of directors may themselves select a new man, subject to ratification (which may or may not be nominal) by the board.

[37] An official of one company informed the writer that the company's board was generally passive but that on important financial matters *individuals on the board* might actively co-operate with the chief executive in reaching a final decision. In 1925, President Dame of the North American Company agreed to purchase control of Western Power Corporation without first consulting the board as a whole, although he did confer with "certain influential members of the board." (Federal Trade Commission, *Utility Corporations*, S. Doc. 92, Pt. 72-A, 70 Cong. 1 sess., p. 69). An influential director in Youngstown Sheet and Tube took a prominent part, along with the chairman of the board and the president, in the negotiations leading up to the proposal to merge the company with Bethlehem Steel in 1930. See 46 *Ohio Appellate Reports*, 268 ff. G. F. Baker's opinions and influence were very important in the top counsels of the New York Central, as were those of E. B. Morris in the Pennsylvania Railroad. See *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. 1182, Pt. 3, pp. 1228-29, 1290, 1669.

influential directors play a more important part in decision-making and co-ordination than does the board of directors as a whole.

In earlier chapters, management organization was described as a pyramid. As we moved downward, the threads of authority and control spread out below the chief executive; as we moved upward, they converged on him. We saw, too, that the apex of the pyramid was not always a single point;[38] sometimes it was a plateau occupied by several men, perhaps by the chief executive and a formal committee of officers. We may now elaborate the picture still further. At the top of the pyramid, authority and decision-making may spread outward and upward—from the chief executive or a top management group to influential members of the board, and perhaps even to the more powerful of the interest groups connected with the corporation. From the chief executive outward we find recommendations, suggestions, and advice shading from the clearly distinguishable decision-making of the chief executive himself to the "environmental influences" and pressures of various interest groups that directly or indirectly condition decision-making by management. It is not easy nor is it essential to mark clearly the line beyond which suggestions and influence are a part of the decision-maker's "environment" rather than a part of decision-making itself.[39] The important fact at this point is that there may be a diffusion of decision-making outward (as well as downward) from the chief executive, and that this diffused decision-making shades, gradually or rapidly, into a composite of environmental influences of varying degrees of strength.

STANDING COMMITTEES OF THE BOARD

The great majority of the boards of large corporations have at least one standing committee, and frequently more than one. They are ordinarily of two types. On the one hand, there

[38] More accurately, the pyramid is sometimes truncated.

[39] We shall have more to say on this in the chapters on stockholders and other interest groups. See Chaps. 7-11.

are the committees entrusted with supervision over all or a broad range of the company's activities, ordinarily bearing the title "executive committee." We should include here also finance committees of the board. The latter are concerned with primarily financial problems but, through control and supervision of financial decisions, they can influence practically the entire range of the company's activities.[40] On the other hand, there are the more narrowly functional committees, such as the salary or bonus committee.[41] Of these, the first type is by far the more important. In a study of the boards of 497 large and small corporations, the National Industrial Conference Board found that 286 had at least one committee.[42] In all, these 286 companies reported 415 committees, classified as follows:[43]

Name of Committee	Number
Executive	241
Finance	49
Salary	22
Trust[44]	15
Bonus, profit sharing, and pension	11
Audit	11
Others	66
Total	415

It is to be emphasized that these figures cover large and small companies and are therefore not necessarily typical of the very large corporations in which we are interested. The guess may be hazarded, however, that substantially all of the committees other than those in the first group were reported

[40] Some so-called "finance committees" really function as executive committees and deal with non-financial as well as financial problems.

[41] These board committees of both types are to be sharply distinguished from the executives' committees which were discussed in Chap. V. It will be recalled that we divided the latter also into two types, general management and functional committees.

[42] Of the 108 corporations in this sample with assets of 50 million dollars or more, 90 had at least one special committee. Boards of large corporations are much more likely to have special committees than are those of small ones.

[43] *Prevailing Practices Regarding Corporation Directors*, p. 16.

[44] Committees of this type were apparently all reported by banks.

by corporations with assets of at least ten million dollars.[45]

The more specialized committees, of which the most common are those dealing with executive compensation and profit-sharing, frequently participate actively in decision-making in the fields allotted to them. In several companies studied, such a committee determined the chief executive's salary and made the more important allotments under existing bonus plans. Such committees may also decide on the character of the bonus system. Although our information on this point is too scanty to permit making broad generalizations with any assurance, it is probably safe to conclude that these committees, where they are active, participate with the chief executive in initiating decisions in the field of their concern and also exercise a final approval function—either themselves or jointly with the executive or finance committee (if there is one) or perhaps with the board as a whole. Our information does not permit us to state further what fraction of all such functional committees is really active. In general, however, they play only a minor part in the process of decision-making taken as a whole.

Executive and finance committees, when they are active, may play a much more important role. According to the usual set of by-laws, the executive committee is empowered to direct all the affairs of the company (with some exceptions) during intervals between meetings of the board. Possession of this power to act for the board in the general supervision of the company's affairs may be taken as the essential characteristic of the executive committee—except that, where a

[45] Asset classes are given by the Conference Board for the number of companies reporting one or more committees, but not for the separate tabulation of kinds of committees. Of the 286 companies with board committees, 94 reported assets of 10 to 50 millions, and 90 reported assets of more than the latter figure.

It is not possible to discover all the board committees set up by these large companies without, as the Conference Board did, directly querying the companies being covered. Functional committees are seldom listed in annual reports. Executive and finance committees usually are, but the writer's interviews uncovered several such committees which were not listed in the companies' annual reports.

finance committee also exists, the latter is given the power to act in financial matters.[46] In practice, *active* executive or finance committees serve in two capacities. Through frequent meetings, they substitute for the board in approving (and perhaps helping to formulate) some of the more important decisions currently and continuously being made by the executives. This implies also participation in the exercise of the co-ordinating function. Secondly, they act as a "filter" for the board with respect to recommendations to be offered at regular board meetings. Matters rejected by the committee are not likely to be submitted to the board; decisions approved by the committee usually receive the board's automatic approval. In this way, the executive committee *may* arrogate to itself the entire approval function of the board.

A small minority of the companies studied had both an executive and a finance committee. When both committees are found in the same company, officers ordinarily make up the majority or at least a substantial minority of the executive committee, while the finance committee is likely to consist predominantly of outside directors.[47] Where both committees exist, the former group, in so far as it is active at all, generally concerns itself with broad supervision of current operations; the latter has as its province approval of large appropriations, dividends, new financing, and similar matters.[48]

[46] Thus, in a large oil company, the executive committee is given "all the powers of the Board in the management of the business and affairs of the Corporation . . . ; but excluding the matters hereinafter . . . assigned to the Finance Committee. . . ."

[47] In American Smelting and Refining, in a recent year, 9 out of 13 members of the executive committee, but only 4 of the 10 members of the finance committee were officers. In the du Pont company, the executive committee was made up entirely of officer-directors; of the 10 members of the finance committee in 1937, 7 devoted only a part of their time to the company's affairs (though a majority of them were included in the company's list of officers). (See the company's annual report for 1937, especially pp. 19-20.) In the railroads, since so few officers serve on the board, the executive committee is likely to be made up predominantly of outside directors.

[48] For a description of the functions of the executive and finance committees of the du Pont company, the first of which is particularly active,

The more common practice is to have either an executive or a finance committee, but not both.[49] As we saw on page 138, executive committees considerably outnumber those concerned with finance, although some corporations have only the latter.[51] In companies having only one, it is likely to function, regardless of its title, as an executive committee, usually with particular emphasis on supervision of financial matters—in so far, that is, as its approval powers are not taken over by the officers' group.[52]

In some companies, executive and finance committees are more passive than the board and seldom meet. In other companies they are energetic and influential bodies which do some initiating and more or less completely take the place of the board in the exercise of the latter's approval function. In other cases, the committee may meet regularly and frequently but for the most part merely automatically approve recommendations submitted by the chief executive.

Even the active executive or finance committee does little initiating, except perhaps with regard to such matters as making dividend recommendations to the board, setting executive compensation, and (perhaps jointly with the chief executive) choosing new candidates for the board to be sub-

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see a case study of the management of this company prepared by the Harvard Business School. The executive committee, being made up entirely of officers, could, like that of the Standard Oil Company (New Jersey), be considered a powerful general-management committee of executives. See p. 104, above.

[49] In a few cases, some other title is used. Thus the board of General Motors now has a "Policy Committee." (The company's Administration Committee is not formally a committee of the board, and its membership includes some officers who are not directors). The Pennsylvania Railroad has a Finance Committee and a "Road Committee" of the board, the latter dealing with non-financial matters.

[50] Of the 31 large industrial companies studied by Holden and others, two thirds had an executive committee but less than one fourth had a finance committee. (*Top-Management Organization and Control*, pp. 226, 227.)

[51] For example, Chrysler Corporation and United States Steel.

[52] On the other hand, the finance committee of one corporation studied did concern itself primarily with financial matters. It is interesting to note that the new directors' committee of the North American Company was entitled "executive and finance committee." *New York Times*, Nov. 2, 1939.

mitted to the stockholders.[53] In so far as it exercises any positive leadership, the executive or finance committee is primarily an approving and co-ordinating body, concerning itself with financial matters, executive compensation, and, less often, crucial operating decisions. In general, so far as the committee's approval powers are real and not nominal, they are largely confined to important financial problems. Approval of these matters is exercised, as we have seen, in two ways. Meeting frequently, the committee may more or less continuously approve important decisions currently being initiated by executives. Secondly, it acts as a "filter," rejecting or passing on management recommendations to the board. Typically, recommendations approved by the executive committee are automatically accepted by the board as a whole.

The active executive committee that meets frequently may exercise also part of the co-ordinating function. It is able to scrutinize regularly reports on recent and current operations and estimates of the company's present and future financial condition, and it is an important instrument for effecting co-ordination through its ability to reject or modify proposed expenditures. Through frequent discussions with the chief executive at its meetings, therefore, the committee may effectively participate with him in curtailing unprofitable operations, protecting the company's financial position, and otherwise better co-ordinating the firm's activities.

On the whole, the majority of the executive and finance committees studied participated in active leadership only to a minor extent. While a few wielded a large degree of control, most of them seem to have either automatically accepted management recommendations or exercised an independent approval power over only a limited range of decisions. The participation of these committees in active leadership cannot

[53] In an equipment company, for example, the dividend recommendation came from the executive committee; on other matters presented to the board, initiation came from the officers' group. In another concern, the finance committee initiated the dividend recommendation. The board of each company had only the one committee mentioned.

compare with that of the chief executive, but, in general, it is greater than that of the board as a whole.

Even when the executive committee does not regularly exercise an independent approval power, its members may still serve as important advisers to the chief executive. If the influential directors mentioned on pages 135-37 are members of the executive or finance committee, their advice and suggestions may in good part be given to the chief executive at the meetings of the committee.

It should be stressed that the director's committee made up mainly of officers is not a body independent of the executive group.[54] The executive committee made up primarily of officers may or may not be active as a committee. If the executives choose to operate collectively on certain matters through the committee, the latter really represents a general management committee of officers, such as those discussed in Chapter V.[55] If the management officials choose to exercise a collective approval and co-ordinating function outside of the executive committee, then the latter becomes merely a hollow shell. Its members take part in leadership in their capacities as officers, not as members of the executive committee.[56]

THE DIRECTOR'S ROLE IN THE LARGE CORPORATION

Our general conclusion is that the board of directors in the typical large corporation does not actively exercise an important part of the leadership function.[57] Not all boards are completely passive, and individual directors and standing

[54] One or two outside directors may be members for the counsel they are expected to offer, but control will be with the executives.

[55] See pp. 103-04. Of the 22 executive committees found by Holden and others in their study of 31 large industrial companies, officers made up from 60 to 100 per cent of the committee in 14 cases. *Top-Management Organization and Control*, p. 226.

[56] In one company, an executive committee made up exclusively of the four most important executives seemed to do little, as a formal body, except participate with the finance committee in making dividend recommendations. In another company, the executive committee (five of whose seven members were officers) was inactive and did not meet except on call.

[57] Paul E. Holden and his collaborators present a considerably different picture, summarized as follows: "In substantially all the companies re-

committees of the board may on occasion exercise a significant degree of leadership. Nonetheless, our analysis does not suggest any substantial modification of the broad conclusion reached in Chapters IV and V, namely, that the body of executives, rather than any other group, is primarily responsible for business leadership in most very large corporations.

In a number of cases, executives made up an actual majority of the board. In these companies, as we have seen, the board can no longer be considered a separate and independent body, whatever its activities may be.

More important than the predominance of executives is the fact that boards of directors as formal bodies do not exercise a significant degree of active leadership in most large corporations. There is no question that initiation of decisions comes from the executive group rather than from the board. The latter's failure to initiate decisions or to formulate policies is less significant than the fact that directors have largely yielded their approval powers to the group of officials whom in theory they are supposed to supervise. To say that most boards of directors, at least in the very large corporation, are passive is to say that they do not actively exercise an independent power of veto or approval over the decisions of the chief executive and his fellow officers. Further, if the board initiates no decisions, and if its approval power has very largely gone by default to officials, it cannot be an effective coordinating group. In general, therefore, the board as a whole

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viewed [all were very large], the board of directors establishes broad basic policies, handles major financial matters, selects the officers and sets their salaries, and takes care of other matters of a similar character. In addition, it receives reports from the management of the company's operation since the last meeting, and passes judgment as to whether, in view of circumstances, the results are satisfactory." (*Top-Management Organization and Control* (Stanford University Press), p. 17. See also the appendix.) How much of the activities that these writers attribute to directors represents actual practice in the particular companies that were studied, and how much is merely a summary of what was found in the companies' by-laws, we are not in a position to say. We should suppose, from our own study, that this part of their analysis reflects conditions as they are supposed to be rather than conditions as they actually are.

is left as a not too wieldy body representing a diversity of interests whose non-officer members, in so far as they are active, function chiefly as advisers. As a formal group, the board takes little part in the leadership function, and the selection of its members rests much more on the management whom it is expected to supervise than on the stockholders whose interests it is supposed to represent.

While this is the general picture, the situation will of course vary from company to company. Some boards do wield an independent control over at least a limited range of management decisions. And even when the board as a whole is passive, particular directors may still participate in leadership. Less important perhaps than this individual influence is the leadership that may be exerted by various committees of the board. Some executive and finance committees exercise an approval function with respect to at least a limited range of management recommendations, particularly on financial matters. Others have completely taken over the approval and co-ordinating functions of the board as a whole. In general, while these committees are likely to exercise more of a leadership function than the entire board, they still are considerably less important than the executive group in their contribution to business leadership.

Thus, for the most part, the board of directors as a formal group has surrendered its function of active decision-making in the large corporation. "Outside" directors function, if at all, primarily as financial and business advisers. The value of advice by competent and interested directors should not be minimized. But the job of actually making the decisions which are the essence of the leadership function rests primarily with the executives themselves.

Those who seek to restore the board as a true decision-making body misread the problem of large-scale management organization. The withering away of the active leadership function of the board is unavoidable. It is merely a reflection of the fact that large-scale business leadership can

be performed efficiently only by a single group of working officials willing and able to devote the necessary time to the business. Non-officer directors, however, have other roles to play. Executives need the advice of outside directors, and, what is even more important, we must rely on the board as an independent body to provide the link between executives and those outside groups whose welfare the company exists to serve. In Chapter XIV we shall investigate briefly how the board can be made to play its part more effectively without at the same time interfering unnecessarily in the leadership job which executives have to perform.[58]

[58] A study of directors which promises much useful information is now being carried on by John C. Baker, Ralph Baker, G. E. Bates, and M. T. Copeland, all of the Harvard Business School. I am informed that their findings to date suggest that in the last few years boards of directors, and particularly their executive committees, have been playing a more important part in their companies' affairs than my own analysis—applying primarily to the middle and late 1930's—suggests. The final results of their study will be awaited with great interest, at which time it will be possible to check the findings of this chapter with theirs, taking into account what we have said concerning the advisory function of outside directors and the leadership activities of particular influential directors and some executive committees.

CHAPTER VII

INTEREST GROUPS AND BUSINESS LEADERSHIP

The exercise of business leadership is not always confined to executives and directors. Various outside groups, even if they do not participate actively in decision-making, have power and exert influence which at times strongly condition the plans and policies of those within management who make the final decisions. When we come across discussions of "financial control" or "minority control," it is to the power and influence of certain of these groups (bankers and minority stockholders) that reference is being made. Since the direction of such an outside influence reflects the interests of the particular persons exercising it, we shall refer to them as "interest groups."

WHO ARE THE INTEREST GROUPS?

By an "interest group" we mean one whose economic welfare depends directly and to an important degree on the activities of a given firm; for example, sellers of goods to an enterprise; labor, which sells its services; bondholders, who provide capital. The interests of these groups usually (but not necessarily) arise out of buying and selling relations between them and a given firm. The basis of such an interest goes beyond current claims for services rendered. Keeping the firm as a customer and improving the bargaining position of the selling group in order to make future sales on more favorable terms may be the dominant considerations which move outside groups to attempt to influence business decisions. This would be true of the suppliers of the firm's raw materials; it is equally true of labor, of bankers, and of a number of the other groups that will be mentioned in a moment.[1]

[1] Political strategy and "power politics" are found in the modern market place as well as in legislative halls; in Wall Street as well as in

The interest groups in the large corporation—not all of whom are sellers of goods and services—can be variously classified. The following is one possible classification. Each category represents an economic group which, to further its own interests, may seek to influence the decisions, and thereby the activities, of the large corporation.[2]

1. Owners (stockholders), whether ownership arises from investment of capital or watered stock.

2. Lenders of money funds, both short-term and long-term.

3. Suppliers of goods by sale or lease, for example, materials, equipment, land, and so on.

4. Customers.

5. Firms in the same or related industries affected through competitive relationships.

6. Labor.

7. The government, both as provider of certain services and collector of taxes and also as the representative of the public welfare (as this is conceived by those in political power).

8. Providers of organization services, chiefly financial, legal, and engineering.

In this and the four chapters which follow, we shall try to evaluate the role of these outside interest groups in the exercise of business leadership in the large corporation. In particular we must address ourselves to two questions. To what extent do various of these groups actively participate in

Washington. Where the buyers are a few large firms, and the sellers are also few and large, political jockeying is particularly likely to take place—either to affect prices bid and offered or to affect sales at given prices. Tactics here range from the standard repertory of the high-pressure salesman to more subtle (and powerful) means of influencing the purchasing company's policy, for example, through interlocking directorates between buyer and seller, acquiring stock in the buying company, the establishment of reciprocal buying and selling relationships, and so on.

[2] This list is a modification of one given in R. A. Gordon, "Financial Control of Large-Scale Enterprise," *American Economic Review*, Vol. 29, Supplement (March 1939), p. 88. The analysis of this chapter stems very largely from the ideas presented in that article.

decision-making? And, when they do not, how and to what extent do their power and influence condition the activities of those who do make the leadership decisions?

POWER, INFLUENCE, AND ACTIVE LEADERSHIP

Some of these groups are more powerful than others. During the 1920's and earlier decades, financial groups possessed a great deal of power in many large corporations. Important minority stockholders acquire a significant degree of power through the size of their ownership interest. In recent years, the power of government has been steadily increasing; in wartime, it becomes all-embracing.

When an interest group acquires considerable power—enough, for example, to replace those actively responsible for policy or on occasion itself to formulate important decisions for the company—that group is frequently said to be "in control."[3] This type of control, however, is something different from the real decision-making and co-ordination encompassed in our concept of business leadership. An interest group may possess a great deal of power, but this power is seldom translated into all the policy-formation and decision-making necessary for guidance of the firm's activities.

In considering the impact of the outside interest groups on the manner in which business leadership is exercised in the large corporation, we must distinguish among three related but distinct concepts. These are power, influence, and active leadership.

[3] Berle and Means speak of "control" as "something apart from ownership on the one hand and from management on the other." Further, "we may say for practical purposes that control lies in the hands of the individual or group who have the actual power to select the board of directors. . . ." See Adolph A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property* (The Macmillan Co.), pp. 69-70. More recently, Means has spoken of non-market (as well as market) controls as "the ability of one individual or group to influence the policies in respect to the use of resources which are adopted by another individual or group." (National Resources Committee, *The Structure of the American Economy*, Pt. 1, p. 153.) The emphasis here is on the actual influencing of policy. The analysis of Chap. 9 of *The Structure of the American Economy* (Pt. 1) is in many respects similar and in all respects pertinent to the discussion of this section.

Power resolves itself into an ability to do something. The power of any interest group may be measured by its ability to do three things: (1) induce management to heed its wishes, (2) force management to permit it to participate in the decision-making and co-ordination which constitute business leadership, and (3) change the personnel of the management group at will. A given interest group may have some degree of power in terms of one or both of the first two of these criteria without being powerful enough to force a change in management. If it possesses sufficient power to change management, it automatically possesses the other two types of power.

Power, however, is not the same as *business leadership*. Power alone is merely the ability to do something, not the actual doing. A powerful interest group may wield only a very general sort of *influence* over the management of a firm; it may seldom actively participate in decision-making. This is often true of bankers, large stockholders, and others who are said to "control" particular corporations. As we shall see in Chapter VIII, the very considerable power which the Rockefeller family and its associates possess in various of the Standard Oil companies has translated itself into very little decision-making by the Rockefeller group in recent years. Here the power (control?) possessed by this interest group is potential and passive. The du Pont company owns sufficient stock in General Motors to give it a great deal of power over the management of the latter company. In the early twenties, that power enabled the du Pont group to participate extensively in decision-making in General Motors. In recent years, while the power has remained, active leadership by this group has apparently steadily diminished.[4] Power, then, may permit an interest group to participate in active leadership, but the mere possession of power is not the same as the actual exercise of the leadership function.

A powerful interest group, because it is powerful, possesses

[4] This case is discussed at length in Chap. 8.

a certain degree of *influence* in the affairs of a corporation; that is, its desires, opinions, advice, remonstrances, or cajolings tend to be heeded by management. However, this sort of pressure is not decision-making if management itself, taking into account its own inclinations and these outside influences, makes the final decision. These pressures make up a part of the environment within which the active business leader operates.[5] True, influence over the decision-maker shades imperceptibly into actual performance of part of the leadership function. It becomes decision-making if the advice or opinions of the interest group are taken by management as orders which it must obey.[6] While there may be considerable room for argument as to whether, in a particular case, the influence exerted is tantamount to actual decision-making, the two concepts should be kept distinct. Even when it is not decision-making, the influence conditions the leadership of those who do make the decisions.

While we emphasize this distinction, we should repeat, to make it perfectly clear, that a powerful outside interest group *may* assume some part of the leadership function and actively participate with management in decision-making and co-ordination. Numerous illustrations will be found in the two chapters following.

Although power is not the same as active leadership, the concept is important to an understanding of how and by whom leadership is exercised in the large corporation. First, power means ability to participate in active leadership. We must look, therefore, among the more powerful interest

[5] Compare Chap. 1, pp. 6 ff. This point may be illustrated further. Business policy-makers shape their price and market policies with an eye to the known attitude of the federal government toward agreements to restrain competition. If those in charge of a firm's policies, therefore, avoid certain competitive practices, this does not mean that the government has taken over the function of business leadership. This is an obvious case in which influence is not leadership. Known attitudes of a strong labor union or of a powerful banking group or fear of what important competitors may do are similiar influences in the businessman's environment.

[6] As when a particular management takes orders from, or submits decisions for the approval of, a powerful and active stockholding group.

groups to discover to what extent they do participate in the leadership function. Secondly, the power of these groups enables them to influence the decision-making of the active business leaders. We should try to discover to what extent and in what ways the power that interest groups acquire does affect the decision-making of the active business leaders.

HOW INTEREST GROUPS ACQUIRE POWER

As already noted, most of the interest groups stand in a selling relationship to the large corporation. If the commodity or service supplied is of particular importance to the firm and if the supply is subject to unified control,[7] the interest group providing the service or commodity may be able to wield considerable influence. Despite the importance to the employing firms of the services provided by labor, the labor group was unable to exert much influence until it became organized and its individual members thus enabled to act in concert. Power may also be acquired by a group when their contractual rights in a company are threatened. The importance of creditor groups—bondholders, bankers, and merchandise creditors—in corporate reorganization is a case in point.

An interest group is likely to possess a significant measure of power if, for any of a number of reasons, an especially close relationship exists between it and the management of a large firm. Common social and economic backgrounds, common historical antecedents based on the earlier life of a company, and the fact that important executives were appointed through the influence or with the help of members of a particular group are among the reasons for a close tie between management and a given interest group. Bankers and im-

[7] If substitute commodities or services are easily available, or if the commodity or service can be dispensed with entirely for a considerable period, the supplying group is not likely to be able to acquire much power over the firm. Even if the commodity or service is indispensable, the group is not likely to be able to acquire much power if its members do not act together.

portant stockholders are much more likely to benefit from such relations than the labor group or even customers.[8]

The interest group representing the customers of a firm can acquire power if one or a few buyers dominate the market and if these buyers use their bargaining power.[9] The most important group of all, the government, possesses unlimited potential power even in a political system based upon the institutions of private property, (relative) freedom of business enterprise, and universal franchise. The powers of the government may be dormant, or they may crystallize into the wielding of a positive influence or even into active participation in decision-making. How active an influence this power becomes and the direction which it takes depend in turn upon the relative strength of the various pressures which the other interest groups bring to bear on those who administer the affairs of government.[10]

Of the stronger interest groups, the ones which have commanded the most attention in discussions of business leadership and corporate control have been stockholders and bankers. The power of stockholders is based ultimately upon contractual rights granted by law. The extent to which these rights can be translated into power depends upon factors largely associated with the dispersion or concentration of ownership, which will be analyzed in detail in Chapter VIII. By law stockholders have the right to assume the leadership function, or to delegate it to those of their own choosing. It is

[8] Close relations may also frequently exist between the managements of competing companies. The executives of the various firms face common business problems, their social and business backgrounds are likely to be similar, and they meet often at business and social affairs. As a result, competing firms (one of the interest groups listed on p. 148) may exert considerable influence on the management of a given corporation. The influence is not direct; rather it is a part of the "conditioning environment" within which the management of a given firm makes its decisions. The importance of this influence is discussed further in Chap. 11.

[9] See pp. 253-54, below.

[10] See the more detailed discussion of government influence on business leadership in Chap. 10.

no secret, of course, that these legal rights frequently have no substance in fact. They are likely to acquire substance only if ownership is concentrated—if the members of the group are few and act together. In this respect, the conditions whereby stockholders acquire power are similar to those applying to the other interest groups.

The financial groups present an interesting case. Unlike the stockholders, they have been given no special prerogatives by the law. Yet they have wielded great power, both in the community at large and with respect to particular firms. The concentration of large-scale banking—both commercial and investment—into few hands, the concentration of investable funds among relatively few individuals and institutions, and the harmony of interests among these individuals and groups have meant that the supply of funds and financial services has been subject to a fairly high degree of unified control.

Naturally the degree of power that the bankers can obtain will depend upon the relative strength of the other interest groups. Though the powers of owners have declined with the diffusion of ownership, the potential powers of the government have come to be used more vigorously than formerly. The effect of this increasing governmental influence on the power and leadership of bankers is discussed in Chapter IX. In addition to the pressure exerted by the government, the relative strength of two other groups in particular, namely, the management and the ownership segments, seems to be most important in explaining the continuous presence of marked banker power. Some firms, especially if there is no large minority interest and management is not particularly strong, may continually be under some measure of domination by financial interests. On the other hand, a strong and able management may continue in complete control, even though reliance on bankers for aid in expansion or for other purposes has been necessary. The Chrysler Corporation apparently represents such a case.

The strength of the various interest groups not only differs from firm to firm but also changes with the passage of time. In the half-century ending with the financial reforms of the New Deal, the power of banking interests reached its peak and then began a decline. The power of labor has been steadily growing, at an accelerated rate since the early 1930's. Most significant of all, the power of government has been steadily and irresistibly increasing. How the power of these groups has tended to change in recent decades will be discussed further in Chapters VIII-XI, in connection with a more detailed analysis of the way in which each of the important groups impinges on business leadership in the large corporation.

CHAPTER VIII

THE ROLE OF THE STOCKHOLDER

Of the interest groups mentioned in the preceding chapter, the body of stockholders is the only one to which the law grants special powers to participate in the leadership function. Legal right and *de facto* power, however, are different things. While much has been made of the wide gap between the stockholder's nominal rights and his actual power in the large corporation, the precise role which the stockholding group plays in large-scale enterprise has never been made very clear. We shall attempt to throw some additional light on this problem in the present chapter.

THE DIFFUSION AND CONCENTRATION OF OWNERSHIP

The ownership of most large corporations has by now become widely diffused. According to a recent study of the Securities and Exchange Commission, there were in 1937 some 8 to 9 million stockholders in the United States. The same study estimated that the 200 largest non-financial corporations had in that year about 3 million stockholders (eliminating duplications), representing a total of about 8.5 million separate holdings.[1] The great majority of these stockholders, of course, owned relatively small blocks of stock. Of the 7 million holdings of common stock in the 200 largest corporations in 1937, 88 per cent were of 100 shares or less.[2] It is these small stockholders which gives us the familiar picture of corporate ownership without "control."

There is another side to this picture of the distribution of

[1] TNEC, *Distribution of Ownership in the 200 Largest Nonfinancial Corporations*, Monograph No. 29, pp. 10, 22, and App. 1. The obstacles, in the form of insufficient data, to a precise estimate of the number of stockholders, in either all corporations or the 200 largest, are insuperable. The SEC estimate, however, seems clearly to be the most careful and accurate that has thus far been made and may be accepted as representing the closest approximation which can be reached on the basis of available data.

[2] TNEC Monograph No. 29, p. 30.

corporate ownership. Extreme inequality characterizes the ownership of securities as well as of other kinds of property. We saw in Chapter II that the very small group made up of the 20 largest stockholders in each of 176 giant companies owned in 1937 as much as 24 per cent of the common stock outstanding.[3] Further, less than 3 per cent of the total number of common stockholdings accounted for half the value of the outstanding common stock of the 200 largest companies in 1937.[4] The same sort of inequality marks the ownership of the stocks of smaller corporations. For all corporations, it has been estimated, less than 1 per cent of the total number of stockholders accounted for 50 per cent of all dividends received by individuals.[5]

We have, therefore, a dual picture regarding the distribution of corporate ownership. On the one hand, there is the great mass of small stockholders, each owning but a minute fraction of any one company's stock. At the other extreme, we find a substantial fraction of corporate ownership concentrated in the hands of relatively small groups of large stockholders. In discussions of the separation of ownership and control, it is the impotence of the small stockholder that is usually emphasized. In studies of the concentration of economic power, on the other hand, much is made of the wealth and influence of the large stockholder. We must examine the role that each plays in the large firm.

[3] See p. 34, above. This excludes banks and brokers holding stock for unnamed beneficiaries.

[4] TNEC Monograph No. 29, p. 40. These figures refer to shareholdings of record rather than individual stockholders. No adjustment has been made for the 24 subsidiaries in the SEC list of the 200 largest companies.

[5] TNEC Monograph No. 29, p. 13. The fact that, say, as few as 1 per cent of the total number of stockholders own 50 per cent of the stock of a given corporation may or may not indicate something concerning "control" by this relatively small group. If the corporation has 250,000 stockholders, 1 per cent of this total amounts to 2500 separate holdings. The possibilities of continuous co-operation among this many individuals and institutions are obviously very seriously circumscribed. Ownership may be quite concentrated, in terms of the fraction of stock held by a *relatively* small group, but this relatively small group may comprise far too many independent stockholders to permit much unified influence to be wielded by the group as a whole.

THE IMPORTANCE OF THE SMALL STOCKHOLDER

A given stockholding may be small in two senses. It may be small in absolute dollar terms, or it may represent a small fraction of the total stock outstanding. In the first sense, we may say that all holdings below some arbitrary figure—say, $10,000 or $1,000,000—represent small holdings. In the latter sense, we may say that ownership of less than, say, 1 or even 5 per cent is small. For the large corporation, absolutely small holdings in the first sense are almost certain to be small holdings also in the second sense.[6] But a "small" holding in the second sense may not fit at all our ideas of a "small" holding in dollar terms. Thus, at the end of 1937, the Sun Life Assurance Company of Canada owned 117,450 shares of the common stock of American Telephone and Telegraph Company. Though the largest holding of record, these shares constituted only 0.63 per cent of the total outstanding. In relative terms, this is certainly a small holding, though at the same time many readers may have difficulty in accepting as "small" an investment of approximately $17,000,000, the value of these shares at the end of 1937.[7]

The commonly held picture of the small, passive stockholder is of an individual whose holdings are small in both relative and absolute terms. For a discussion of control and business leadership, however, the relative or percentage rather than the dollar-value criterion is the more significant. For our purposes, a "small" stockholder is one who owns but a small fraction of the outstanding stock of a company,[8] even

[6] There were some cases, even among the 200 largest corporations, in which an amazingly small investment was sufficient at one time to acquire a substantial fraction of the voting stock outstanding. This was true in 1935 of several railroads, because of the extremely low price of the stocks of companies in or on the verge of receivership, and because a large fraction of railroad assets are covered by bonds. A small investment might also buy a substantial fraction of a small issue having exclusive voting privileges.

[7] These figures are taken from TNEC Monograph No. 29, p. 685.

[8] From one point of view, a holding large in value terms may be significant in a study of corporate control even if the holding is small relatively.

if the holding is enough in itself to make the owner a millionaire.

Unfortunately, we have little direct evidence on the distribution of stockholdings according to the percentage of stock owned. Some of the information cited in Chapter II, however, throws an indirect light on the prevalence and importance of relatively small stockholdings.

We noted in Chapter II that the 20 largest stockholders in each of 176 giant corporations owned together about 24 per cent of the total value of the common stocks of these companies.[9] The list of the 20 largest stockholdings included practically all holdings of as much as 1 per cent and a great many that amounted to less than this.[10] If we accept 1 per cent as the dividing line between "small" and "large" stockholdings, we might conclude that more than three quarters of the common stock of the 176 giants belonged to small stockholders—even though many of these "small" holdings had a very substantial market value. This estimate, however, may be somewhat too high. Some holdings of less than 1 per cent belonged to persons associated with a minority group, the total of the group's holdings being relatively large. Small holdings of this sort should probably be excluded in deriving an index of the importance of the small stockholder. After allowance is made for this factor, however, stockholdings of less than 1 per cent would certainly aggregate well over half the value of the common stocks of these 176 large companies. The importance, as well as the prevalence, of the small stockholder does not seem to be open to question.

Large value holdings are owned by relatively wealthy men or institutions, and wealthy men are likely to belong to or be on the periphery of "the financial community." Through this association, wealthy stockholders may exert an influence out of proportion to the fraction of stock they own.

[9] See p. 34, above.

[10] The writer counted only about a half dozen cases among the 176 companies in which the twentieth largest stockholding of common amounted to as much as 1 per cent of the issue. See TNEC Monograph No. 29, App. 10.

THE LEADERSHIP ROLE OF THE SMALL STOCKHOLDER

The small stockholder plays no significant role in the active leadership of the large corporation. This is true above all of those whose holdings are small in both dollar and percentage terms, but it holds also for those whose ownership is large in dollar terms though small as a fraction of voting power.

The small stockholder's failure to share in active leadership follows inevitably from the growing size and complexity of industry and the diffusion of corporate ownership. As a consequence, management must be transferred to trained specialists. By the nature of the case, the rank and file of stockholders cannot continuously initiate or approve leadership decisions, nor can they exercise any continuous coordinating function. Their participation in decision-making is limited to voting at stockholders' meetings. The range of decisions open to them at these meetings is very narrow. Ordinarily it does not go beyond the choice of directors and certain other matters—such as increases in capitalization, mergers, and so on—concerning which a vote of the stockholders is required. In all of these cases, management *initiates* decisions. The stockholder's role is limited to saying yes or no to proposals submitted to him.[11] At best, therefore, assuming that the approval power of the stockholder is real, the typical small stockholder's participation in the leadership function must be of the negative sort, and limited to the few decisions submitted at stockholders' meetings.

In practice, of course, the small stockholder's passivity and impotence are not measured merely by his failure to participate actively and continuously in creative business leadership. He has lost also the power to exercise an independent check on management which the right to vote at stockholders' meetings nominally gives him. It is the loss of this negative

[11] The individual stockholder can of course submit his own proposals at the annual meeting, but this is not likely. If he does, the proposals are not apt to be seriously considered either by management or the other stockholders.

approval power—over occasional management decisions and the choice of directors—which writers have in mind when they speak of the "separation of ownership and control."

The most important cause of the small stockholder's inability to use with any effectiveness the power inherent in his voting privilege is associated with the mere fact of diffusion of corporate ownership. Lack of interest and lack of adequate information—even with the fuller corporate publicity that has come since 1933—have been unavoidable attendants of the permeation of corporate ownership into the ranks of small and moderate-sized investors. Even when the interest is present and the information adequate, the possibilities of effective use of the stockholder's vote depend on the co-operation of other stockholders. The trouble and expense of communicating with thousands of other owners, assuming that stockholders' lists are available, are ordinarily almost insuperable bars to securing such co-operation. Viewed in this fashion, the proxy machinery is not so much a means of depriving the stockholder of his vote as an alternative to his doing nothing with his vote at all. The proxy machinery becomes a partial—and by no means completely satisfactory—substitute for complete disfranchisement.

In many cases, this tendency toward disfranchisement has been intensified by the activities of management or other groups. On occasion, the proxy machinery is deliberately manipulated to perpetuate existing management control and to secure approval of management decisions toward which stockholder opposition might conceivably develop. Use of the proxy machinery for such purposes ordinarily consists of management's soliciting proxies without at the same time supplying adequate information to stockholders. Beyond the deliberate withholding of such information,[12] management's "misuse" of the proxy machinery, if "misuse" is the proper word, consists of keeping itself in power by using its proxies

[12] The SEC has improved prevailing practices in this regard under the powers granted to it by Sec. 14 (a) of the Securities Exchange Act of 1934.

to elect its own slate of directors. In view of the inability of the typical stockholder to nominate his own slate or to judge the merits of candidates suggested by others, management's perpetuation of itself in this fashion is an alternative, not to any real control over election of directors by the stockholders, but to the nomination and election of directors by some other group of individuals close to the corporation —for example, a strong minority group or the firm's bankers. Though there is unquestionably room for improvement in prevailing procedures for soliciting proxies, elimination of management control of the proxy machinery cannot of itself give to the small stockholder an effective voice in the selection of directors or in passing on other important decisions which may come before stockholders' meetings.

Other means have been used to deprive the stockholder of his right to an occasional vote. In some cases, voting power is granted to only a small issue, and the bulk of the stock may be left without any vote at all.[13] The common stock may be put into a voting trust, the stockholders being left with trust certificates carrying no right to vote.[14] Of greater importance, perhaps, corporation laws in the last two or three decades have narrowed considerably the range of matters on which a vote of the stockholders is necessary. Management has been permitted to decide for itself issues which

[13] Not only preferred but also common stock may be without voting rights. The New York Stock Exchange has refused to list new issues of non-voting common since 1926, but a number of non-voting common stocks of large companies are still outstanding. According to W. H. S. Stevens, however, completely non-voting stocks, common and preferred, are not as prevalent as is generally assumed. See his "Voting Rights of Capital Stock and Shareholders," *Journal of Business of the University of Chicago*, Vol. 11 (1938), pp. 326-27.

[14] This device was used when the Pennroad Corporation was created in 1929. It was used for a short time by Consolidated Gas, Electric Light, and Power Company of Baltimore (also in 1929) when the possibility arose that an outside financial group might buy into the company's stock. The voting trust was used by J. P. Morgan in the 1890's and by other bankers later in connection with railroad and other reorganizations, and it has been frequently used after mergers. Among industrial companies in which voting trusts have been used at various periods in their histories might be mentioned International Harvester (after the 1902 merger), General Motors (after the 1910 reorganization), and Armour and Company during the 1920's.

once had to be submitted to the stockholders or concerning which management's discretion had previously been circumscribed by law.[15]

Frequently the stockholder must appeal to the courts to enjoin management from engaging in acts which he considers prejudicial to his and other stockholders' interests. But legal proceedings are expensive, and effective opposition through this channel is ordinarily beyond the means of the small stockholder.

The typical stockholder, then, fails completely to participate in the exercise of active business leadership. Positive and continuous leadership—the initiating of decisions or continuous approval—is entirely lacking, and the situation is not greatly different for the negative sort of leadership that would be associated with an independent use of his vote at stockholders' meetings.

The stockholder's negative control, though ordinarily of little importance, can on occasion become a check to the freedom which management normally enjoys. Stockholder opposition to the management, in so far as it develops at all, is likely to be most prevalent in times of depressed earnings. The depression of the thirties brought with it a greater degree of recalcitrance from their usually meek stockholders than the managements of many large corporations had ever encountered before.

A good deal of this opposition had little immediate result. In so far as stockholders' uprisings took the form of dissenting votes at annual meetings, management ordinarily was able to overcome the opposition through its control of the proxy machinery.[16] Where the revolt was successful, almost always

[15] See W. Z. Ripley, *Main Street and Wall Street* (1927), pp. 37 ff. and other pages; Adolph A. Berle and Gardiner C. Means, *The Modern Corporation and Private Property*, pp. 140-41, 158-59, 180 ff.; Twentieth Century Fund, *The Securities Markets* (1935), pp. 193-99.

[16] See, for example, the attacks on management in 1939 by stockholding groups in Western Union and American Car and Foundry (*New York Times*, Feb. 4, Apr. 13, Apr. 22, and July 14, 1939.) Despite the vigor of the attacks, the managements of the two companies were able to secure a substantial majority of the votes cast at the stockholders' meetings. The

the center of the opposition was a relatively large minority interest, and these cases belong in our later discussion of minority control. Though, in general, management remained in control of the meetings at which opposition developed, the discontent of stockholders had indirect effects. Fear of the unfavorable publicity which attended these fights and the pressure of opinion, both from stockholders and the public at large, led corporation executives to grant some stockholder demands and to institute some changes. To the extent that the outcries of stockholders led eventually to government regulation of various corporate practices, the freedom of management was still further circumscribed.

In recent years, a good deal of the opposition from small stockholders has been concerned with the question of management compensation. Some of this opposition has led directly to revision of salary and bonus scales. Protest against the size of management compensation has come chiefly since 1929—largely as a result of the depressed earnings of the thirties and of the publicity given to executives' compensation by the Federal Trade Commission investigation of 1933 and the reports later required by the Securities and Exchange Commission. Two of the best-known cases in which protest by stockholders led to a revision of management compensation schedules concerned Bethlehem Steel Corporation in 1931 and American Tobacco Company in 1933.[17]

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fight in Western Union was apparently more closely contested and involved more stockholders than did the struggle in American Car and Foundry.

[17] On the Bethlehem Steel case, see the company's letter to its stockholders, July 3, 1931; letters from a Stockholders' Protective Committee, Mar. 20 and Apr. 29, 1931; *New York Times*, various dates between January and July 1931; *Fortune*, June 1931, p. 22; and *Berendt et al* v. *Bethlehem Steel Corporation et al.*, 154 Atlantic Reporter 321. In 1938, suits brought by a few minority stockholders in connection with a proposal to rescind a management stockownership plan established in 1930 were dismissed in the New York Supreme Court. (*New York Times*, Apr. 14 and May 19, 1938.) The controversy in American Tobacco Company involved both a management stock subscription plan and cash bonuses to officers. See American Tobacco Company, *Notice of Special Meeting of Stockholders* (June 25, 1930), *Letter to Stockholders* (Mar. 16, 1933), *Notice of Annual Stockholders' Meeting* (Mar. 16, 1933), *Information Regarding Employees' Stock Sub-*

Other successful attempts of stockholders to oppose the managements of large corporations might be mentioned.[18] More common, however, are the unsuccessful and abortive attempts. Far more common still are the cases in which, even when their interests are prejudiced, stockholders do not organize at all or even remain uninformed on the issues involved.

If legal aid cannot be sought, the efficacy of the stockholder's check on management depends upon the existence of a strong minority interest around which opposition can be rallied. Otherwise, management's discretion (within the limits prescribed by law) is restricted largely by its fear of unfavorable publicity and the stress of public opinion. It is for this reason that the recent pressure to provide greater corporate publicity has strengthened somewhat the stockholder's check on management. But the check is indirect. The small stockholder's vote itself remains an impotent instrument—incapable of giving its owner any active participation in leadership or even a direct veto over occasional management decisions.

"CONTROL" BY MINORITY GROUPS

While the impotence of the small stockholder is ordinarily taken for granted, it is generally assumed that the owners of large minority interests do exert a real and important influence over the operations and policies of many large corporations. Thus Berle and Means classed 46 of the 200

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scription Plan of 1930 (Pamphlet, March 1933); *New York Times*, various dates between February and July 1933; *Rogers* v. *Guaranty Trust Company of New York et al.*, 288 U.S. 123; *Rogers* v. *Hill et al.*, 289 U.S. 582. Further attempts by small minority stockholders to modify the company's bonus plan in 1940 and 1941 were overwhelmingly defeated. See the company's *Letter to Stockholders* Mar. 1, 1940, and *New York Times*, Mar. 1 and Apr. 4, 1940, and Apr. 3, 1941.

[18] Among such cases were the campaign in 1933 to force the management of Allied Chemical and Dye Corporation to publish fuller financial statements, the overthrow of the old management of Freeport Texas Company in 1930, reconstitution of the board of directors of American Smelting and Refining in 1922, and stockholders' suits against the banker-controlled management of Goodyear Tire and Rubber in 1926-27. In most of these cases, leadership seems to have been provided by one or more wealthy stockholders.

largest non-financial corporations in 1929 as representing cases of minority control.[19] A more recent study concluded that about 140 of the 200 largest non-financial corporations in 1937 represented cases of ownership control.[20] It is common practice to refer to certain companies as being "controlled" by some group known to have a large minority interest. Thus one comes across references to "Rockefeller control" of the Standard Oil companies, the McCormick family's control of International Harvester, and so on. A minority interest of 15 or 20 per cent of the voting stock of a company is generally assumed to carry with it, in some sense, working control.

We saw in Chapter II that a substantial minority interest does exist in many large corporations. But what is meant when it is said that these large stockholdings give their owners "control"? Does the word in this context imply the continuous exercise of a good part of the active leadership function? If not, what content is there in the "control" of large minority stockholders? The available answers to such questions are surprisingly meager.[21]

[19] *The Modern Corporation and Private Property*, pp. 94, 99 ff.

[20] See pp. 38-43, above.

[21] Berle and Means, in *The Modern Corporation and Private Property*, used rather mechanical criteria in classifying their companies according to the nature of the relevant control situation. In general, minority control was assumed to exist if a compact group owned as much as 20 per cent but less than a majority of the stock. Minority control, in the sense of the stockholding group having the power to elect the board of directors, was assumed to exist if the minority interest was present, but no systematic attempt was made to see what influence in each company was actually exerted by the minority group.

In TNEC Monograph No. 29 (p. 99), control is defined as "the power of determining the broad policies guiding a corporation." In determining what companies were subject to ownership control, the authors employed not this definition but mechanical criteria similar to those used by Berle and Means. In general, whether a company was classed as being under ownership control or not, depended on the size of the minority group's ownership, the diffusion of the remainder of the stock, and, particularly in the case of the smaller holdings, the group's representation in management. It is certain that, in many companies which the authors classed as under ownership control, the minority group did not exercise control in the sense that it made or actively influenced broad policies. (See p. 44, above.) It may or may not *have had the power* to do so.

In practice, the influence of important minority groups varies widely. Some of them participate continuously and to an important degree in business leadership; others do so only sporadically; yet others contribute little or not at all to the process of decision-making.

The clearest cases of active leadership by a minority interest occur in those corporations in which one or more senior executives are themselves important members of the minority group.[22] This sort of situation, though certainly not typical in the large corporation, was found in a number of the companies included in the present study. For example, at some time during the 1930's, members of the dominant minority interest were leading executives in Inland Steel, du Pont, Deere and Company, S. S. Kresge, R. H. Macy, Firestone Tire and Rubber, Alleghany Corporation, and Utilities Power and Light. In each of these companies, the executives themselves owned, directly or indirectly, 5 per cent or more of the voting stock outstanding in 1935 and in addition were members of a compact group which together owned a still larger fraction of the voting stock.[23] In no case was the total minority interest less than 10 per cent. The relations between the chief executive and the non-officer members of the minority group were extremely close; in a number of cases they were based on family ties. In some of the companies mentioned, other members of the minority group, though not officers, served on the board of directors.

Perhaps the outstanding example of active leadership by a dominant minority group is found in E. I. du Pont de Nemours and Company. About 27.5 per cent of the company's common stock is owned by Christiana Securities Company, which in turn is largely owned and apparently completely controlled by members of the du Pont family and their close

[22] We are considering at this point only companies in which officers of the corporation are themselves leading members of the minority group. We exclude those cases in which senior executives in some sense merely "represent" the minority group, perhaps having been selected by the latter.

[23] Data on stockholdings for these companies are available in reports filed with the SEC. See also TNEC Monograph No. 29.

associates.[24] In 1935, three du Pont brothers were respectively chairman of the board, vice chairman, and president. The same three men held the top three positions in Christiana Securities Company. All officers and directors of the latter company, with the exception of the secretary, were officers and directors of the du Pont company.[25]

The finance committee in the du Pont company was in control of the broader aspects of financial policy, probably with respect to approval rather than initiation. It met every two weeks and considered only large appropriations. This committee was completely dominated by members of the du Pont family and very close associates. Six of the nine members, however, did not give full time to the company.[26]

"The executive committee was composed of nine full-time officers of the company who actively directed its activities."[27] This committee met weekly. Of the nine members of the executive committee in January 1936, one was a du Pont, who was also president of the company. At least four and perhaps five others, however, might be considered close associates of the du Ponts and members of the du Pont group.[28] There is little question that final approval and co-ordination of major decisions, and perhaps some initiation

[24] In February 1938, members of the du Pont family owned 74 per cent of the common and 59 per cent of the preferred stock of Christiana Securities Co., and additional amounts were held by associates of the du Pont family. Members of the family also own stock in the du Pont Company directly or through other holding companies. See TNEC Monograph No. 29, pp. 119-22, 866-69, 1442-43.

[25] Four of the seven directors of Christiana were du Ponts and a fifth had married into the du Pont family. The executive positions in du Pont of three of the Christiana directors were probably nominal, but the other four accounted for the following positions in the du Pont company: chairman and vice chairman of the board, president, chairman of the executive committee, and four out of nine memberships on the Finance Committee. This was the situation in 1935.

[26] Case study prepared by the Harvard Business School and annual report of the company for 1935. The finance committee was enlarged to ten members in 1936.

[27] Case study prepared by the Harvard Business School. This was written in 1936. See also *Fortune*, December 1934, p. 89.

[28] See annual reports of the company and *Fortune*, December 1934, pp. 88-89.

also, came from the members of the dominant minority group. In this case, minority control meant active business leadership.

There are other cases of like character. Thus the leading figures in the management of Inland Steel Company in 1935 had built up the company and still represented a group of closely associated individuals whose holdings comprised a substantial fraction of the stock outstanding.[29] In Swift and Company, business leadership in 1935 still rested with the sons of G. F. Swift, the founder.[30] Though, by 1940, a professional executive was president of the company, three sons of the founder still formed a majority of an informal executive committee of five which met several times weekly and exercised a continuous approval and co-ordinating function.[31]

In some of the other companies mentioned, also, "minority control" meant active leadership by members of the minority group who participated in management.[32] Sometimes, how-

[29] In 1935, L. E. Block was chairman and P. D. Block, president. Two other Blocks were officer-directors. According to reports filed with the SEC, 13 per cent of the stock at the end of 1935 was held by officers and directors. This figure was 11 per cent in September 1939. (TNEC Monograph No. 29, p. 445.) Further substantial holdings belonged to other members of the Block family and to those associated with them in the growth of the company. (See TNEC Monograph No. 29, p. 977; *Fortune*, September 1931, pp. 41 ff.) The writer is indebted to Mr. J. L. Block for information concerning this company.

[30] Holdings of the Swift interests amounted to about 7 per cent of the stock outstanding. This figure was supplied to the writer by the company and refers to the year 1941. The SEC credits the family with only about 5 per cent (in 1937), but this covers the ownership only of those members of the family included among the 20 largest stockholders. TNEC Monograph No. 29, pp. 113, 1335.

[31] Information supplied by the company. See also p. 73, above.

[32] In the Alleghany Corporation, to cite another example, the Van Sweringens, the dominant stockholding group, participated actively in management. Their leadership extended also to the railroads in which, through Alleghany and other companies, they owned a controlling stock interest. Their control of the railroads affected seems to have been concerned with financial and related matters and, to some extent, with operating policy. It undoubtedly included also the choice of a president for each of the roads. See Senate Committee on Interstate Commerce, *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. No. 25, Pts. 4-5,

ever, even though members of the minority group do serve as officers, real leadership may pass to professional executives not members of the stockholding group. Thus in Sears, Roebuck and Company, the key figure in management in 1935 was R. E. Wood, the president, not Lessing Rosenwald, chairman of the board, although the Rosenwald family and related interests owned a substantial fraction of the outstanding stock.[33] Similarly, the McCormick and Deering families (chiefly the former) apparently controlled more than a third of the voting stock of the International Harvester Company in 1936, at which time a McCormick was chairman of the board.[34] Nonetheless, active leadership of the company for some years had apparently been with the president and his chief operating officers. Members or representatives of the McCormick family formed a substantial minority of the board, but, with one possible exception, there is little evidence that between 1922 and 1941 they participated actively and continuously, to any major extent, in decision-making.

8-11, 16, 25, 76 Cong. 1 and 3 sess., J. C. Bonbright and G. C. Means, *The Holding Company* (1932), pp. 253-62.

Another example of leadership by a minority group in a railroad occurred in the Chicago Great Western. The controlling stock interest in this company was held by the Bremo Corporation, a holding company formed in 1929. Patrick Joyce, a member of the Bremo group, became chairman of the executive committee of the railroad in 1930 and was elected president in 1931. He seems to have been the individual most responsible for the policies of that company from the time of his appointment until the road went into receivership in 1935, at which time he was made one of the two trustees for the road. See *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. No. 25, Pts. 12-14. 76 Cong. 3 sess.

[33] The larger individual holdings of the Rosenwald family are listed in TNEC Monograph No. 29, p. 1287. General Wood had been selected by Julius Rosenwald, Lessing's father, to head the company. The growth of the company in the first quarter of the century was in good part the result of the leadership of Julius Rosenwald, president for 15 years and for many years the company's largest stockholder.

[34] According to the Federal Trade Commission, on June 30, 1936, nine stockholders controlled 38 per cent of the common and 20 per cent of the preferred stock. (*Report on the Agricultural Implement and Machinery Industry*, H. Doc. 702, 75 Cong. 2 sess., p. 172. See also TNEC Monograph No. 29, pp. 981, 983.) In addition to Harold McCormick, chairman of the board, the family was represented in the executive group in 1936 by Fowler McCormick, a vice president, who later became president.

Since 1941, however, a McCormick has again been president and active head of the company.[35]

MINORITY CONTROL WITHOUT ACTIVE PARTICIPATION IN MANAGEMENT

Let us consider now the situation in which the minority group is not active in management. Perhaps members of the group serve on the board; in other cases, even if their holdings are very large, minority stockholders may have no official connection with the company.

It is these cases of informal minority control which create the greatest difficulties of interpretation. The "control situations" found among these companies vary widely—from little or no influence to nearly as much participation in decision-making as we found in some of the companies already mentioned. Further, the degree of control exerted is not necessarily a function of the size of the minority holdings.

Active participation in leadership by the minority group frequently occurs in the case of public utilities and railroads in which the dominant stock interest is owned by another utility or railroad.[36] This was much more true, in the public utility field, before the passage of the Public Utility Holding Company Act in 1935 than after. Even afterward, however, the officials of Electric Bond and Share or of its affiliated service company, to take one example, made, or participated in making, important decisions affecting the intermediate holding companies in which it held a large minority interest or the operating companies which the latter in turn controlled. Control over many operating matters was effected through the service company, while on important financial

[35] For a study of the management of the company, see P. B. Coffman, *International Harvester Company*, a case study prepared by the Harvard Business School. The writer is also indebted to an official of International Harvester for information concerning the company. The role of the chairman is apparently a relatively inactive one. Fowler McCormick was an officer of the company before he became president. Until he became the chief executive, he undoubtedly played a role subordinate to that of the president.

[36] We refer here only to cases of interlocking corporate ownership through *minority* holdings. Holding-company control through majority ownership may be taken for granted and is excluded from the present discussion.

matters officers of the intermediate holding companies were apparently receptive to suggestions made by officials of Electric Bond and Share.[37]

Such complete and vigorous participation in leadership, however, is not typical of the cases in which a railroad or public utility has a considerable minority stock interest in another company in the same field. Even among public utilities before the passage of the Public Utility Holding Company Act of 1935, minority control by the leaders of the stockholding company was likely to mean only partial participation in the leadership function in the company so controlled. Approval and (less often) initiation of some major financial decisions and the selection of directors and perhaps key executives are probably the chief ways in which the control is made active.[38]

[37] Before 1935, this giant holding company system was apparently managed more or less as one company. Electric Bond and Share owned controlling interests, varying from 17 to approximately 50 per cent of the voting stock, in each of several large holding companies (Electric Power and Light, American Gas and Electric, American Power and Light, National Power and Light, and American and Foreign Power). The latter controlled the operating companies in the system. Prior to 1935, with important exceptions in the case of American Gas and Electric Company, the parent company supplied officers, office accommodations, and necessary services for the intermediate holding companies, the officers of which were also officers of Electric Bond and Share. After 1935, the intermediate holding companies had their own sets of officers, and the operating staff of the top company was transferred to a separate service company (Ebasco Services, Inc.), which dealt directly with the operating subsidiaries. Less active control has been exercised over American Gas and Electric, which has always maintained its own operating and management staff, than over the other companies named. This has apparently been particularly true since about 1933. On all this see: Securities and Exchange Commission, *Record of Action, Ebasco Services, Inc.*, File Nos. 37-31 and 37-44 (Public Utility Holding Company Act of 1935—Rules U—13-22 and U—13-4, Aug. 23, 1939, on file in the Public Utilities Division of the SEC); *Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control*, H. Rept. 827, Pt. 3, 73 Cong. 2 sess., pp. 437-550; SEC, *Holding Company Act Release* No. 2051 (May 10, 1940), No. 2749 (May 13, 1941), and No. 2962 (Aug. 23, 1941); Federal Trade Commission, *Utility Corporations, Summary Report*, S. Doc. 92, Pt. 72-A, 70 Cong. 1 sess., pp. 616 ff. The situation after 1935, here described, may be subject to substantial changes in the future, as a consequence of regulation by the SEC under the provisions of the Public Utility Holding Company Act.

[38] It is highly probable that the United Corporation, through substantial minority holdings and interlocking directorates, exerted some influence,

In the case of interlocking ownership among the railroads, leadership may also extend to some traffic matters, particularly the routing and interchange of traffic, and to broad plans for expansion and integration. Frequently, if not generally, executives of the controlled company, whether a railroad or public utility, have considerable freedom in making final decisions over a broad range of operating and non-operating matters, and cases of more or less complete assumption of the leadership function by the controlling group are rare.

Among railroads and utilities, as in the industrial field, minority control is frequently a negative rather than a positive force. "Control" in these cases usually implies approval rather than initiation of decisions, and may imply merely an indirect influence rather than direct approval or veto. The purpose of the control is normally to further or protect particular interests of the controlling group, and this may be done without participating in the formation of many, perhaps most, policies.

Of course, a certain amount of "influence" is always present in these cases of minority control whether the control group participates in actual decision-making or not. The manage-

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particularly before 1935, over the managements of such companies as Public Service Corporation of New Jersey, Commonwealth and Southern, Niagara Hudson Power, United Gas Improvement, and Columbia Gas and Electric. This influence, in so far as it affected decision-making in these companies, probably showed itself chiefly with respect to financial decisions which might have affected the interests of United Corporation and in the selection of directors. It is highly doubtful whether the officers and directors of United, except in cases in which they were officers of the other companies, played a very important part in initiating or actively approving the broad range of operating decisions in these other companies. More important than active leadership in these companies by United's representatives were the interchange of advice and the existence of an influence—through the potential power inherent in United's stockholdings and through the community of interests achieved as a result of interlocking directorates—which in all likelihood conditioned the decision-making of the executives in the companies affected. Since 1935, the influence of the United Corporation over these companies has been greatly diminished. For some information on the United Corporation, see FTC, *Utility Corporations, Summary Report*, Pt. 72-A, pp. 111-16, 139, 152, 176-77; *Relation of Holding Companies to Operating Companies*, Pt. 3 (for companies in the United Corporation group), and Pt. 5, pp. 719 ff.; *New York Times*, Oct. 15, 1941.

ment of the controlled railroad or public utility will consider the known attitudes and interests of the controlling group, even if direct pressure is not brought to bear on it. But in this respect, the influence of minority stockholders may not be greatly different from that of other strong interest groups.

In the industrial field, as well as among the railroads and public utilities, minority ownership by another corporation may carry with it varying degrees of active leadership. The same is true when the minority interest consists of individuals rather than another firm. The minority group may be fairly active in the affairs of a given firm on various occasions, but this does not necessarily mean that it continuously exercises all or even most of the leadership function. The degree of leadership associated with minority ownership, even when the minority is active, may vary over a wide range.

A CASE STUDY OF MINORITY CONTROL

The various possible meanings of minority control, in terms of active business leadership, are well illustrated by the history of the du Pont group's minority interest in General Motors Corporation. This is a case in which "minority control" has meant some participation in decision-making at one time or another by members of the minority group; but the participation has been only partial, and the degree of leadership has tended to decline with the passage of time.

At the end of 1937, the du Pont *company* owned beneficially 23 per cent of the common stock of General Motors and had the power to vote about 27 per cent of the stock.[39] This interest in the automobile company began in 1915, when the du Ponts aided W. C. Durant to regain control and Pierre du Pont became chairman of the board.

[39] Nearly all of the du Pont company's interest in General Motors' stock was represented by complete ownership of the common stock of General Motors Securities Company, which owned 27 per cent of the stock of General Motors. (See Annual Report of E. I. du Pont de Nemours and Company for 1937, and TNEC Monograph No. 29, pp. 938-40.) At the end of 1938 the du Pont company announced that it would take direct possession of the General Motors stock then owned indirectly through the Securities Company. *New York Times*, Dec. 31, 1938.

Active leadership seems to have been mainly exercised by Durant, who became president in 1916 and was primarily responsible for the company's rapid expansion in the several years following.[40] By 1918, the du Pont company had publicly admitted that its officers were to share responsibility for financial management of General Motors.[41] In 1920, Durant retired from the company, and the du Ponts assumed complete control for the time being.[42] Pierre du Pont became president as well as chairman, but apparently in a very short time Alfred P. Sloan, though only a vice-president, became the *de facto* operating head of the company. In 1923, Sloan became president.[43] A du Pont remained as chairman of the board until 1937. During the entire period since 1920, numerous members of the du Pont group have comprised a substantial minority of the board.[44]

The policy of internal reorganization followed by General Motors after 1920 seemingly owed a good deal to members of the du Pont group. The reorganization included elimination of unprofitable activities, closer control of finances and inventories, and better control and co-ordination of decentralized operations. This new policy—aiming not toward further rapid expansion but toward more adequate internal co-ordination and control—was in marked contrast to the breath-taking expansionist policies of W. C. Durant. The detailed changes made were undoubtedly the work of Sloan and other executives, but initiation of the general program and approval of

[40] L. H. Seltzer, *A Financial History of the American Automobile Industry* (1928), pp. 172 ff.; Arthur Pound, *The Turning Wheel* (1934), Chaps. 11, 13.

[41] Annual report of the du Pont company for 1918. The report added that the "general function of the du Pont interests is advisory only."

[42] Pound, *The Turning Wheel*, Chap. 13; Seltzer, *A Financial History of the American Automobile Industry*, pp. 203 ff.; Federal Trade Commission, *Report on Motor Vehicle Industry*, H. Doc. 468, 76 Cong. 1 sess., pp. 426-27.

[43] See *Fortune*, December 1938, p. 164; FTC., *Report on Motor Vehicle Industry*, p. 427.

[44] The du Pont group—members of the family, close business associates, and officers of the du Pont company—averaged about six out of a total board membership of approximately thirty during this period.

its broad outlines probably came from the more active members of the du Pont group serving on the board.[45] Selection of Sloan as president in 1923 unquestionably represented a decision of the du Pont group.

It is probable that the du Ponts were active in approving and sometimes even in initiating major financial decisions, particularly in the earlier years. A member of the du Pont group—first J. J. Raskob and later Donaldson Brown[46]—was chairman of the finance committee from 1917 until the committee was abolished in 1937, and both of these men have supposedly participated in shaping General Motors' financial policies.[47] Members of the du Pont group regularly formed a substantial fraction of the finance committee, though their representation on the executive committee (which was also eliminated in 1937) steadily declined. The du Ponts apparently participated in setting up the company's famous bonus plan.[48] Awards under the plan were recommended by Sloan to the finance committee,[49] on which the du Ponts were well represented, but in all probability the committee's approval was nominal.

Since 1923, participation of members of the du Pont group in active leadership seems to have declined as final approval

[45] See *Fortune*, April 1938, pp. 110, 112, and December 1938, p. 164; Seltzer, *A Financial History of the American Automobile Industry*, p. 211. As a matter of fact, interesting analogies can be drawn between the methods of management organization and control which were established in General Motors and those in the du Pont company.

[46] Raskob was an officer in the du Pont company and a close associate of Pierre du Pont. Brown married into the du Pont family and, when this was written, was a director but not an officer of the du Pont company. His chief business connection seemed to be his position in General Motors.

[47] Raskob has been given credit for originally interesting the du Ponts in General Motors. (Annual report of the du Pont company for 1919.) He also is said to have been in good part responsible for the formation of General Motors Acceptance Corporation. (*Fortune*, December 1938, p. 167; February 1939, p. 106.) Pound (*The Turning Wheel*, p. 352) states that Raskob strongly influenced General Motors' dividend policy when he was chairman of the finance committee. For mention of Brown's influence in organizing General Motors' financial operations, see *Fortune*, April 1938, p. 75.

[48] See Seltzer, *A Financial History of the American Automobile Industry*, pp. 220-21.

[49] Annual report for 1935.

of major decisions came to rest more and more with Alfred Sloan, president until 1937 and chairman of the board thereafter. The lessening influence of the du Ponts on operating policy can be measured in part by their declining representation on the old executive committee; and their participation in financial decisions (except for Donaldson Brown) has probably declined, also. The evidence is reasonably conclusive that in such matters as changes in management organization, decisions as to acquisitions and expansion, selection of major executives, determination of executive compensation, and changes in the company's system of distribution, the final authority in fact has for some years been Sloan, not the board of directors or members of the du Pont group.[50] There is little evidence that members of the group have interfered with or directly influenced management's decisions regarding prices, labor policy, engineering, or the variety of other problems that arise in the production and sale of the company's products.[51]

The du Ponts were given no representation on the company's Administration Committee when it was set up in 1937, and General Motors executives formed a majority of the Policy Committee, also. There is little doubt that today, whatever the potential power and informal influence of the du Ponts, active leadership and direct responsibility for major policies are the prerogatives of Alfred Sloan and of his major executives, supplemented by the exercise of some approval function by the Policy Committee. It is possible that some modification of this generalization is necessary in the case of financial policy, but in recent years even this modification may not be of great importance.[52]

[50] See the references to General Motors in Chaps. 4-5; also *Fortune*, April 1938, pp. 75-76; December 1938, pp. 41, 170, 178; January 1939, p. 108; February 1939, p. 105. Further information has been secured from several officials of the company.

[51] Some influence can be seen in the General Motors' use of United States Rubber Company's tires after the du Ponts bought into the latter company. See *Fortune*, February 1934, p. 127.

[52] The du Pont influence in United States Rubber Company, based on a 20 per cent stock interest acquired in the winter of 1927-28, bears a strong

Numerous other cases might be mentioned in which the major executives are primarily responsible for decision-making but in which a strong minority group possesses considerable influence and occasionally participates, primarily through approval of some decisions, in the leadership function. The influence of these groups cannot be ignored, but it is even less possible to ignore the fact that typically these groups do not even try to assume the entire mantle of business leadership.[53]

resemblance to that in General Motors. Appointment of F. B. Davis to head the company in 1929 clearly represented a decision of the new minority group. (Davis had already served the du Ponts in various capacities.) The appointment of William de Krafft to be in charge of financial matters also involved at least active approval by the du Ponts. Subsequent policies of the management, involving financial retrenchment, pruning unprofitable operations, and setting up a system of decentralized but co-ordinated management, are similar to those followed in General Motors and clearly reflect the attitudes of the du Pont group toward management organization and control. The sale of additional stock to raise new funds in 1928 and particularly the inauguration of an elaborate plan for executive compensation in 1929 reveal the exercise of leadership by the du Ponts.

As in General Motors, evidence of active leadership by the du Ponts declined rapidly after the first few years. There is no indication of any interference today in the broad range of operating decisions or in the details of financial management. Representation of du Pont interests on the board has regularly been smaller than in General Motors. President Davis probably consulted with the du Pont group when important matters arose or reported informally to them from time to time, but the major responsibility for active leadership seems to have rested with him and his major executives. They, not the du Ponts, initiated and approved price, labor, and investment policy, decisions as to new products and important technical changes, and otherwise guided the company. Potential power, a conditioning influence, informal advice, and perhaps occasional approval of some policies represented minority control in this company in 1940. For information on this company, see *Fortune*, February 1934; H. and R. Wolf, *Rubber*, p. 463; and annual reports of the company, particularly for the year 1929. Additional information has been supplied by the company.

[53] In 1935, to cite another example, Cliffs Corporation and Cleveland-Cliffs Iron Company (the former held all of the common stock of the latter) owned directly and indirectly a substantial minority interest in the voting stock of Republic Steel Corporation, and two of the directors of the latter company were chosen at the suggestion of officers of Cleveland-Cliffs. (Prospectus of Republic Steel Corporation, Sept. 11, 1935.) Further, Republic is an important customer of and seller to Cleveland-Cliffs. Nonetheless, the dominance of T. M. Girdler in the management of Republic Steel at that time is clear. Similarly, M. A. Hanna Company owned 28 per cent of the voting stock of National Steel in 1935 and had three men on the board of directors, one of whom was chairman of the executive committee.

"PASSIVE CONTROL" BY MINORITY GROUPS

In nearly all the cases thus far discussed, minority control has meant some participation in active business leadership. In other companies, however, minority control is more or less completely passive, and years may go by without the control group taking any real part in the leadership function. Examples of prolonged passivity by the minority group are by no means rare.

Some 18 per cent of the voting stock of Pacific Gas and Electric Company—to cite an example from the utility field—was owned directly or indirectly by North American Company in 1941.[54] Nonetheless, the evidence is reasonably conclusive that neither the officers nor the directors of the latter company have participated in leadership of the Pacific Coast utility company. In 1939 two representatives of the stockholding company were on the board of Pacific Gas and Electric, but apparently they seldom attended meetings and made no attempt to influence management decisions. Even in financial matters, the minority group exercised at best a limited influence.[55] The composition of the board suggests that the influence of local financial interests has been far stronger than that of the North American Company.[56]

In National Steel also, however, the chief executive (E. T. Weir) was apparently the dominant figure in the company. See prospectuses of the company, May 28, 1935, and Apr. 25, 1938; *Fortune*, June 1932, pp. 31 ff.)

[54] Securities and Exchange Commission, *Holding Company Act Release No. 2988* (Sept. 11, 1941). North American's minority interest originated not in an attempt to acquire control but as the by-product of the sale of certain properties to Pacific Gas and Electric.

[55] See the report of the trial examiner *In the Matter of Pacific Gas and Electric Company, et al.* (SEC Public Utilities Division File No. 31-55, dated Apr. 16, 1941); SEC, *Holding Company Act Release No. 2988; Fortune*, September 1939, p. 123.

[56] In 1939, all but two of the directors resided in California. In general, they were officers of the company or represented Californian stockholdings or financial groups. (See the report of the trial examiner *In the Matter of Pacific Gas and Electric Company, et al.*) The chief possible indication of decision-making by North American Company is that James Black, the president of P. G. and E. from 1935 on, had been an officer of North American and of its subsidiary, Great Western Power Company. He became a director of Pacific Gas and Electric in 1930, when North American sold

The most important examples of passive minority control arise out of the transmission of family holdings to succeeding generations. There is a pattern in the evolution of ownership and control which is common to many large American corporations. During a company's earlier years, active leadership rests with the individual or group who built up the company, this early leadership being reinforced by substantial ownership. With the death of the original leaders, ownership passes to new generations of the families concerned; and gradually the responsibility for active decision-making is relinquished by members of the stockholding group and passes to professional executives, who frequently have been trained by the original leaders. In some cases, through public sale, the minority interest disappears. In other cases, it remains but becomes increasingly passive. Perhaps the heirs sit on the board of directors, but, even if they do, their role as *active* leaders in these companies is likely to be largely or entirely nominal.[57]

This is the present situation in the Procter and Gamble

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certain California properties to that company in exchange for stock. It is said that his choice as president in 1935 reflected the independent judgment of the more influential directors and did not result from any pressure brought to bear by the North American Company. (See the report of the trial examiner previously cited; *Holding Company Act Release No. 2988;* and *Fortune*, September 1939, pp. 122-23.) Some influence from North American, however, may very well have been involved.

The SEC, in September 1941, ruled that P. G. and E. was subject to the controlling influence of North American and denied the former's application that it be ruled not a subsidiary of North American. (*Holding Company Act Release* No. 2988.) The Commission's decision was based, however, not on evidence of active interference by North American in the affairs of P. G. and E. but "primarily on our finding that North American has the *power—if the occasion arises and if it so desires*—to make its influence felt in a substantial and affirmative manner." (The same, p. 23. Italics mine.)

[57] Most of the important family interest groups associated with various of the 200 largest non-financial corporations are now in their second and third generations. This is true, for example, of the Mellon, Rockefeller, Duke, Hartford, Widener, Harkness, and Woolworth families. It is true also of the present dominant branch of the du Pont family. "Only relatively few of the large [family] interest groups . . . are still largely represented by the founders." TNEC Monograph No. 29, p. 130.

Company. The Procter and Gamble families still own a substantial minority interest, but professional executives today make the company's policies. There is no evidence of any important participation in decision-making by members of the minority group.[58] The situation does not seem to have been greatly different in Sears, Roebuck and Company, particularly after Lessing Rosenwald's resignation as chairman of the board.

The outstanding example of passive minority control is found in the Rockefeller family's relations to the corporate descendants of the old Standard Oil Trust. Members of the Rockefeller family and Rockefeller-endowed institutions have owned in recent years from 10 to 20 per cent of the voting stock of the Standard Oil companies of New Jersey, Indiana, Ohio, and California, Socony-Vacuum Oil Company, and Ohio Oil Company.[59] In each of these companies, active leadership is clearly in the hands of professional executives. Typically, major executives constitute all or nearly all of the board of directors; and neither members nor representatives of the Rockefeller family serve as directors.

There is no indication that in recent years the Rockefeller interests have interfered directly in operating or financial policies; to an increasing extent, the companies compete among themselves despite the degree of common ownership; they have pursued independent price and expansion policies;

[58] Members of the Procter and Gamble families appearing among the 20 largest stockholders owned about 10 per cent of the common stock in 1937. (TNEC Monograph No. 29, p. 1227.) Additional holdings, not included in the 20 largest, were probably held by other members of the two families. (For additional information on this company, see *Fortune*, December 1931, p. 98; and April 1939, pp. 77 ff.; Herbert Feis, *Labor Relations: A Study Made in the Procter and Gamble Company* (1928), pp. 4-10.) The influence of a man now dead, William C. Procter, is of greater importance in shaping management attitudes and decisions than is the power inherent in the present family ownership.

[59] Holdings of the 100 largest stockowners in each of these companies, as of Dec. 31, 1938, are given in TNEC Hearings, Pt. 14-A, pp. 8003 ff. For earlier information, see *Report on Pipe Lines*, H. Rept. 2192, Pt. 1, 72 Cong. 2 sess.

and the managements of the companies seem to be self-perpetuating.[60] It is true that in 1929 John D. Rockefeller, Jr., interposed to oust the head of Standard Oil Company of Indiana. This oft-cited incident indicates the degree of power latent in the Rockefeller holdings and the Rockefeller name, but it does not necessarily imply either continuous or sporadic participation in decision-making immediately preceding or after 1929.[61] Some informal advice may be forthcoming from the leaders of the Rockefeller interests, and the influence and potential power of these interests cannot be denied.[62] But active leadership rests with management.

The historical background of a company and particularly the training received by its leading executives may have more to do with shaping management organization and policies than the influence of an important minority group. It is the "Rockefeller tradition" rather than the present Rockefeller holdings which actively conditions management decisions in the Standard Oil companies. This tradition is largely responsible for present methods of management organization and internal control, use of the committee

[60] Direct evidence of the presence or absence of Rockefeller leadership is difficult to obtain. The indirect evidence for the most part deals with the types of decisions made by the managements of these companies. This partial and indirect evidence has been supplemented by interviews with executives in the oil industry. For published material—dealing directly or indirectly with the question of Rockefeller control—see *Fortune*, December 1931, p. 51; April 1940, pp. 148 ff.; June 1940, p. 61; J. K. Winkler, *John D., A Portrait in Oils* (1929), pp. 169-70; TNEC Hearings, Pt. 15 and Pt. 17, pp. 9660 ff.; G. W. Stocking, *The Oil Industry and the Competitive System* (1925), pp. 70-78, 104-14; and references to the Standard Oil Companies in Chaps. 4-6, above.

[61] A stronger influence, probably involving actual participation in decision-making, existed in the years immediately following the dissolution of the Standard Oil Trust. For the changes in management which followed the dissolution, see Allan Nevins, *John D. Rockefeller*, Vol. 2 (1940), p. 604.

[62] In 1936, Standard Oil Company (New Jersey) floated a bond issue of 85 millions, of which a substantial amount was sold directly to various Rockefeller foundations. (Prospectus for the issue, May 27, 1936.) A strong "influence" is here indicated. It is entirely possible that the Rockefeller interests suggested the direct sale to the foundations. If so, not merely influence but decision-making was involved, although the management of the company could probably have vetoed the suggestion had it so desired.

system, and the domination of boards of directors by officers. The same tradition and background have had much to do with the competitive relations among the several companies, and the "Rockefeller tradition" has undoubtedly also helped to shape management attitudes toward various types of operating and financial problems.[63] A similar situation exists in other companies subject to differing degrees of "minority control." Thus one hears of the "McCormick tradition" in International Harvester and of the influence of William C. Procter in Procter and Gamble.

Minority groups are not necessarily always active or always passive. A normally passive minority group may suddenly become active, and a once active group may more or less gradually give up its share in the exercise of the leadership function.

Rockefeller's intervention in the Standard Oil Company of Indiana in 1929 represents an example of sporadic leadership by a minority interest that was normally passive. In the years immediately following the merger of the Colgate and Palmolive-Peet companies in 1928, the Colgate family, while owning the largest block of stock in the new company, participated actively in management only to a minor extent.[64] In 1933, however, after a short period of unsatisfactory earnings, the Colgate interest assumed direct control. S. B. Colgate became president; important changes were made in the board of directors and executive personnel; and a number of new policies were instituted. This period of active Colgate leadership continued until 1938. In that year, S. B.

[63] See Winkler, *John D., A Portrait in Oils*, pp. 168-69; *Fortune*, March 1931, p. 45; April 1940, p. 148. In 1936, the ten members of the board of the New Jersey company had spent an average of 34 years with the company. In other Standard Oil companies, also, the training and background of many major executives date back to the days of the old "Trust." For an interesting description of management organization in the predecessor company, see Nevins, *John D. Rockefeller*, Vol. 1, pp. 673-78, 681.

[64] S. B. Colgate was made a vice-president but soon resigned. Two other Colgates held the positions of chairman and vice-president, but the real power in the company was Charles Pearce, of the predecessor Palmolive-Peet Company.

Colgate retired to the less active role of chairman, although he and other members of the family retained their posts as directors. Control by this group is still probably more active than it was before 1933, but it does not now represent the same degree of participation in decision-making that it did between 1933 and 1938.[65]

Illustrations of more gradual changes in the nature of "minority control" have already been mentioned—for example, in the case of the du Pont interest in General Motors. The transmission of family holdings to succeeding generations normally carries with it a gradual lessening in the degree of leadership exercised by the minority group. Typically, the leadership thus yielded is assumed by professional executives. On occasion, however, some other group—for example, investment bankers—may take over part of the leadership function.

In the public utility field, an important change in the nature and degree of "minority control" has taken place since 1935. Substantial minority ownership by holding and "superholding" companies has meant much less influence and actual participation in decision-making by the stockholding companies since the passage of the Public Utility Holding Company Act. At the same time the "controlling" companies themselves have become subject to a considerable extent of control—involving approval or veto of management decisions and, in the case of integration, even initiation of decisions—by the Securities and Exchange Commission.

THE SIGNIFICANCE OF MINORITY CONTROL

From the evidence of the preceding pages, it is clear that "control" by stockholding minority groups may vary from almost complete passivity to vigorous and extensive participation in the leadership function. Ordinarily, the voting strength of minority groups translates itself into only limited partici-

[65] For further information on Colgate-Palmolive-Peet Company, see *Fortune*, April 1936, pp. 120 ff.; annual reports of the company, especially for the years 1933 and 1938; and the prospectus of the company dated Mar. 19, 1940.

pation in active business leadership. Typically, in the large corporation, management is primarily responsible for major policy-making, including both initiation and approval, and for direct co-ordination of the firm's operations. Minority control is most likely to mean extensive participation in decision-making when members of the minority group are themselves major executives.

It is not at all surprising that family ownership is coming to mean less and less participation in active business leadership by members of the stockholding group. Today, family holdings in most very large corporations belong to the second, third, or even later generations. Interest in the business ordinarily tends to decline as holdings are inherited by later generations, and the interests of the original owner's children and grandchildren may well lie in other fields, perhaps outside the sphere of business entirely.[66]

Through bequest and inheritance, family holdings typically break up into more numerous and smaller segments. Important minority holdings in the large corporation today are seldom owned by one or even a few individuals. In many cases, substantial fractions of the minority group's total ownership become frozen in trusts—usually with a bank or trust company as trustee[67]—and a large segment may belong to women and minors. The larger and more diverse the minority group, the less likely it is to exercise much real leadership in any company.

To some extent, the tendency for family stockholding groups to become more unwieldly with the passage of time has been offset by the use of family holding companies and the setting up of trusts under a common trustee. Through

[66] Sometimes the minority ownership and the influence and desires of the founder lead members of the next or later generations to take an active part in the business. Witness the Swifts, the Deeres, an earlier generation of McCormicks as well as the McCormick who now heads International Harvester, Winslow and Brown in United Shoe Machinery, and others.

[67] Banks and trust companies, acting for numerous unspecified beneficiaries, were among the twenty largest stockholders of record in practically all of the 200 largest corporations studied by the SEC. See TNEC Monograph No. 29, App. 10.

these devices, voting control of the stock may continue to be concentrated—in the hands of those who direct the family holding company or of the trustees—even though beneficial interests in the stock become spread over a steadily increasing number of individuals.[68] These devices unquestionably tend to concentrate the power inherent in the minority holding into a few hands, even if the family group itself is very large. Whether this concentrated power means also sharing with management in active leadership depends on the men who control the power to vote the stock and on other factors. The leaders of a family holding company may choose to take a direct interest in the controlled company. They may, however, choose to be relatively passive or perhaps take a hand in decision-making only sporadically. If the stock is held in various trusts, the fact that there is a single trustee for all the stock does not imply active leadership. Typically, the trustee is a bank or trust company. Officers of the bank may serve as directors of the company, but, unless palpable inefficiency or worse is indicated, the bank is not likely to try to substitute its judgment for that of the company's management. In all probability, representatives of the bank will play an active role only in participating in the choice of a new chief executive (and frequently not even then) and perhaps in influencing some types of financial decisions in which its interests, or those of its clients, are likely to be particularly affected.

Some family holdings in established companies arise through direct purchase, as did the du Pont holdings in United States Rubber. Deliberate purchase of substantial minority holdings usually implies an intention to exercise some degree of real leadership, if only to effect a reorganization or to carry out a merger. Where this is the case, minority control may imply considerable, though not complete, participation in decision-making for some period. If the minority holding results from a merger or the acquisition of one company by another, the new minority group

[68] See TNEC Monograph No. 29, pp. 74, 101-02, 601-02, and App. 10.

may very well play an inactive role unless one or more members are taken in as officers of the merged or acquiring company.[69]

While the role of minority groups in active decision-making may be limited, we must not minimize their power and influence. Minority control always represents potential power and usually considerable influence.

The power of minority groups stems from the ability, inherent in their collective voting strength, to change the management of a company. The mere existence of this power, quite apart from any threat to use it, cannot help but be an important conditioning influence operating on management. How strong this influence will be in any company depends on a number of factors: the size of the minority holding, the compactness of the group, the aggressiveness and interests of its leaders, the profitableness of the enterprise, and the character of the chief executive of the company. To this last point we attach considerable importance. If the chief executive is able, aggressive, and naturally independent, the influence of even a strong minority group may be very small, though the ability to remove the executive may still be there.

In addition to the power inherent in the minority group's voting strength, the mere wealth of the group may give it considerable power. Wealth automatically carries with it some degree of economic power and influence. Wealthy minorities can enlist the support of bankers and other financial leaders, and they can use the power of these associates to reinforce their own power if they desire to become active. Out of these financial interrelations and business asso-

[69] This will depend in part upon whether the owners of the acquired company were active in the business and, if they were, whether they wished to retire after the merger. Andrew Carnegie retired when his company became a component of the United States Steel Corporation in 1901. His lieutenant, Charles Schwab, however, became president of United States Steel and served in that capacity for several years. Both the Guggenheims and the McCormicks went on to the leadership of the larger corporations (American Smelting and Refining and International Harvester) into which their family enterprises were merged. See also pp. 183-84, above, for a brief account of the activities of the Colgates in Colgate-Palmolive-Peet.

ciations comes a strong set of influences which can condition the direction of business leadership.

In terms of its effect on business leadership, the power inherent in minority ownership has a twofold importance. First, it provides the source of a continuous influence which helps to condition the attitudes and activities of those who are the business leaders. Second, the power is important as power. In the group resides the *ability* to change those who do make the decisions and to make the decisions themselves. From the point of view of both business efficiency and compatibility with the assumptions of political democracy, there is reason to question whether concentration of this much economic power in these particular groups is wise or desirable. This question takes on added relevance when we consider that these groups assume no responsibility to the community or to any interest broader than themselves that is commensurate with the power that they possess. On the other hand, they do provide a check on management itself. The small stockholder, for example, may have to rely on minority groups to protect his interests against an irresponsible management seeking to pursue policies which run counter to the interests of the stockholders as a whole.

The ability to select or change the management of a company is the criterion most often used by other writers in ascribing "control" of a corporation to a particular group. We have not followed this practice because "control," thus used, carries implications concerning active decision-making which are frequently not true. We may, rather, use the phrase "*ultimate* control" to describe possession of this sort of economic power. It is important to remember, however, that ultimate control—the ability to change management—is not the same as the actual decision-making and co-ordination which are encompassed in our concept of business leadership. Ultimate control means power and influence. It may or may not mean some degree of participation in decision-making. It never means, in the large corporation, complete assumption of the function of business leadership.

CHAPTER IX

THE INFLUENCE AND LEADERSHIP ACTIVITIES OF FINANCIAL GROUPS

Among the individuals and institutions making up the financial interest groups, commercial, private, and investment bankers stand out as occupying a particularly strategic position. There is a substantial degree of concentrated control by commercial banks over the supply of short-term credit. This is perhaps most serious in the case of the small firm dependent upon the local bank, but commercial banks may acquire power over large firms as well—not only when the firm's operations are chiefly local in character but also when corporations operate on a national scale.[1] Similarly, strong control over the channels of supply of long-term credit is held by investment bankers, although, as we shall see later, this control is weaker now than it once was.[2]

The strategic position of banks and bankers is further strengthened by the close relations which frequently exist between them and large individual and institutional investors, the latter looking to the former for advice and guidance. Such relations have existed between insurance companies and investment trusts and bankers, though the vigorous scramble to

[1] Power by commercial banks seems to arise in two types of situations. One type represents the influence which comes from lending. The other type is the more interesting and in some ways of greater fundamental importance. The larger commercial banks in any city are likely to be the rallying point and to provide the leadership for the city's financial interests. As a result, local capitalists sit on the bank's board, and representatives of the bank are found on the boards of important concerns which have an interest (financial or otherwise) in the city in question. Boston provides a good example of such a situation. See National Resources Committee, *The Structure of the American Economy*, Pt. 1, App. 13, pp. 312-14.

[2] An unwritten rule—which, however, is occasionally broken—forbids open competition among bankers for the business of a firm ordinarily dealing with a given banking house. (See, for example, *Stock Exchange Practices*, Report of the Committee on Banking and Currency, S. Rept. 1455, 73 Cong. 2 sess., pp. 85-87; TNEC, Hearings, Pts. 22-24.) On the degree of concentration in the investment banking field, see TNEC Hearings, Pt. 24, pp. 12689 ff.

invest idle funds during the 1930's probably caused some of these relations to become somewhat less cordial than they had been. Close relations are maintained also between banks and important stockholding groups.[3] As we noted in Chapter VIII, commercial banks and trust companies frequently represent substantial stockholdings residing in trusts and estates which they administer. In general, common interest in money funds and securities tends to strengthen the ties among all the financial groups mentioned.

As a result of the importance of financial activities to the large firm, there is a marked tendency for management and stockholding groups to seek the advice of bankers as financial experts. Banker representation on the financial committees of boards of directors is by no means due exclusively to the insistence of the bankers themselves. Further, management itself may in particular cases be closely related to bankers as well as to other financial interest groups. Common social and economic origins or interests, as well as the general importance to the corporation of financial matters, play a part here.

Although bankers, therefore, constitute a powerful interest group, the extent of their leadership activities in the large corporation should not be exaggerated. Much has been written about the alleged control of large-scale enterprise by bankers and other financial groups. As we emphasized in Chapters VII and VIII, however, possession of power does not necessarily involve extensive participation in decision-making. In this chapter, we shall examine the nature of "banker control" and shall attempt to determine how much influence is actually exercised by financial groups on the leadership function in the large corporation. For our purpose, the analysis may be limited to the power and activities of investment and commercial banks and bankers.[4]

[3] See, for example, National Resources Committee, *The Structure of the American Economy*, Pt. 1, App. 13, pp. 314-15.

[4] In terms of the interest groups listed in Chap. 7, the financial groups would include: (1) lenders of money funds, including (a) short-term lenders such as commercial banks and (b) long-term lenders (bondholders),

HOW FINANCIAL GROUPS ACQUIRE AND USE THEIR POWER

In practice, certain occasions have been particularly propitious for the acquisition of power by financial groups. When corporations are undergoing rapid expansion or consolidation, when they are in financial difficulties—in short, whenever they have a special need for funds or financial services—the situation is favorable for an extension of bankers' influence over their affairs. The fact that power has been acquired by financial interests, however, does not necessarily mean that such power is translated into continuous exercise of some part of the leadership function, nor that the influence extends into all aspects of the company's affairs. Banker participation in decision-making, further, has been more prevalent in the railroad and public utility fields than among industrial companies. This seems to be true even if we consider only the larger industrial companies of the same order of size as those found in the other two fields.

Expansion and flotation of securities. As has already been suggested, financial interests are likely to acquire power when a firm is undergoing rapid expansion. This was the case with some of the railroads in the nineteenth century and was true also of the development of certain public utility systems after 1890.[5] Bankers played an important role in connection with

particularly institutional investors such as banks and insurance companies; (2) those providing financial services. The most important institution in this latter category is the investment banking house. Before the Banking Act of 1933, private and commercial banks also acted as investment bankers Commercial banks and trust companies, while no longer having investment banking affiliates, may still provide some types of financial services to the large corporation.

[5] A large part of the expansion of the American railroad network took place before the rise of the larger investment banking firms that played such an important role from about 1890 on. In many young railroads, groups of wealthy individuals played the role, in supplying capital and acquiring power, which investment bankers were later to play in rapidly expanding public utility and industrial corporations. See, for example, the histories of the New York Central, Southern Pacific, and Santa Fe. Financial difficulties and bankruptcy were more important causes for the acquisition of power by bankers over the railroads than the mere need of funds for expansion. It is true, however, that much of the financial difficulty that the railroads encountered in the last quarter of the nineteenth century arose out of

the mergers and system-building which characterized the growth of the public utility industry, and they were apparently also influential in the expansion of a number of industrial companies in the 1920's.

It is entirely possible that expansion may require banker co-operation and yet lead to the acquisition of little power by banking groups. This seems to have been the case with such companies as Chrysler Corporation and Swift and Company. Of course, some firms have been able to expand largely out of retained earnings and thus to avoid reliance on bankers. This has been true of a number of companies in the automobile industry, the Ford case being particularly well known, and in other fields.

Bankers are likely to acquire power not only through the issuance of new securities or the granting of short-term credits to finance expansion but also in the negotiations leading up to the consolidation of two or more companies or the acquisition of one company by another.

In the case of new security issues, bankers often take some part in decision-making for the moment—with respect to the terms of the new issue, formation of a syndicate, and in some instances the exercise of a final veto on whether new securities are issued or not.[6] Leadership in the company's affairs by

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unwise and too rapid expansion. See E. G. Campbell, *The Reorganization of the American Railroad System, 1893-1900* (1938).

In connection with the earlier expansion of public utility systems, it is interesting to note that in some cases the sellers of equipment and construction services were forced to play the role of bankers and to finance, by accepting securities, the expansion of some utility systems. This was true of Electric Bond and Share, which was created by General Electric Company as a resting place for the securities of utility companies which it had taken in exchange for equipment, and of Standard Gas and Electric, which was set up by the Byllesby interests under similar circumstances. See, for example, *Utility Corporations*, Summary Report of the Federal Trade Commission, S. Doc. 92, Pt. 72-A, 70 Cong. 1 sess., pp. 86-87, 94-95.

[6] "In relation to the borrower, the investment banker assumes a role which is charged with heavier responsibilities than that of mere purchaser of the securities for resale to the investing public. The investment banker performs the functions of a financial adviser to the borrowing corporation, determining many important questions such as the kind of security to be issued—mortgage bond, convertible bond, debenture, preferred or common stock—the time of issuance of the security, and the price of the security to the

financial interests may not extend beyond these matters, although under certain conditions, as we shall see, banker participation in the leadership of the company may persist for some time. The fact that a banking house has the exclusive right to sell a company's securities does not in itself necessarily mean that bankers exercise any substantial part of the leadership function in that company. The investment banker's advice to management in connection with the raising of new capital may represent participation in decision-making with respect to that particular transaction. But the banker may have little to say, except when his advice is sought, about other decisions made by management, whether he serves on the board of directors or not.[7]

In the case of a consolidation or merger, financial interests are likely to enter into a considerable amount of decision-making. Bankers may determine the conditions for bringing the companies together and for issuing new securities, and they may also choose (or participate in choosing) the directors

public. The relationship between the investment banker and the borrowing corporation is of a semi-permanent character. Once established, it generally is respected by other investment bankers." S. Rept. 1455, 73 Cong. 2 sess., p. 83.

[7] See, for example, what is said of American Telephone and Telegraph, pp. 207-14, below. A similar situation apparently prevails in Sears, Roebuck and, probably not quite to the same degree, in General Foods, to mention two industrial companies. Both of these companies are attached to particular banking houses, but—at least in Sears, Roebuck—it is doubtful that the bankers' participation in leadership today extends much beyond the floating of new issues and the giving of financial advice. In the case of General Foods, banker participation in the leadership function probably has amounted to something more than this, particularly in the period of the company's rapid expansion. In recent years, bankers on the board have probably been as active as other directors, but there is little evidence that the firm's bankers, as bankers, have seriously impinged on decision-making by management. (See *Fortune*, October 1934, p. 122; *Stock Exchange Practices*, Hearings before the Senate Committee on Banking and Currency, Pt. 2, 72 Cong. 1 sess., pp. 569-75.) Kuhn, Loeb and Company are the bankers for Inland and a number of other steel companies, but the exercise of the leadership function is securely in the hands of the managements and, to a less extent, of the dominant minority stockholders in these companies. This is true, also, of General Motors. J. P. Morgan and Company handled such securities as the company had to sell from 1920 on, and members of the Morgan group served as directors. Nonetheless, leadership of the company was firmly in the hands of the management and the du Ponts.

and chief executive who are to head the new company.[8] Out of the merger is likely to evolve a relationship between the company and bankers which gives the latter a continuing voice in financial affairs and the right to head future underwriting and selling syndicates for the company's securities.

In the public utility field, where banking interests have played an important part not only in mergers but in the related activities connected with the building up of giant holding company systems, investment banking houses frequently acted as promoters. The leadership of these banking houses prior to 1935 in holding company promotions and expansion was an important factor in determining both the distribution of operating plants among the public utility empires and the kinds of capital structures with which many holding companies emerged from their periods of rapid expansion.[9] In spite of the importance of banking interests in the public utility field, however, banker control has not meant participation to the same degree in all types of decision-making. Active leadership by bankers has apparently centered around financial matters: the timing and nature of security issues, expansion and the building up of holding company systems, and other matters of financial strategy. Sometimes, the initiation of plans

[8] This was true, for example, in the formation of United States Steel in 1901 (see p. 203, below), and also of other mergers at that time. Blair and Company played an active role in the negotiations and transactions leading up to the acquisition of the prairie oil and pipe line companies by Sinclair Consolidated Oil and the eventual formation of Consolidated Oil Corporation in 1932. (*Stock Exchange Practices*, Hearings, Pts. 6-7, 73 Cong. 1 sess.; Securities and Exchange Commission, *Investment Trusts and Investment Companies, Report on Abuses and Deficiencies in the Organization and Operation of Investment Trusts and Investment Companies*, H. Doc. 279, 76 Cong. 1 sess., pp. 227 ff.) J. P. Morgan and Company played the leading role in the formation of Standard Brands, Inc. in 1929. (*Stock Exchange Practices*, Hearings, Pt. 1, pp. 188 ff.) Numerous other cases might be mentioned.

[9] For a general discussion of the influence of investment bankers in public utility holding companies, see Federal Trade Commission, S. Doc. 92, Pt. 72-A, 70 Cong. 1 sess., especially pp. 75 ff. See also *Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control*, Report of the Committee on Interstate and Foreign Commerce, H. Rept. 827, 73 Cong. 2 sess., especially Pt. 3. Regarding the situation since 1935, see pp. 218-19, below.

may have come from the banking group; more often it was a matter of sharing with management in final formulation and approval of decisions. In companies in which a marked degree of banker power prevailed, choice of directors and the chief executive undoubtedly sometimes rested with members of the financial group.[10] There is little evidence, however, that banking groups intervened directly in the formulation of operating decisions; and in rate-making, of course, regulatory commissions have played a more important role than any other outside group.

Financial difficulties and reorganization. Another type of situation in which banking and other financial groups are likely to acquire power occurs when a corporation finds itself in financial difficulties. Investment and commercial banks have control of the supply of new funds that are necessary, and they are not likely to permit these funds to go to a company in financial trouble without the exaction of terms. In addition, financial matters are the regular business of bankers; security holders look to them for leadership when trouble occurs; and they are better equipped and more strategically located than other groups to head protective and reorganization committees.

Bankers may acquire power over a firm in financial difficulties even if reorganization is not involved. In 1910, General Motors found itself in need of financial aid after a period of too rapid expansion. The granting of such aid resulted in the acquisition of considerable power by banking interests. Later, in 1920, the need of financial aid led to banker representation on the board and finally to a transfer of power

[10] Commonwealth Edison was formerly a member of the Insull system, and substantial blocks of its stock were pledged to various commercial banks as security for Insull's loans. The banks held this stock for a number of years after collapse of the Insull system. In 1939, when a new chief executive was to be appointed, a Chicago banker on the board of Commonwealth Edison conferred with representatives of the New York banks involved, before the appointment was announced. *New York Times*, Nov. 27 and Dec. 2, 1939.

from W. C. Durant to the du Ponts.[11] Other companies yielded to some banker influence in 1920-21. An interesting example of a company that staved off receivership at that time only by submitting to a very large amount of influence and a considerable degree of active leadership by a banking group was the Goodyear Tire and Rubber Company.[12] Again in the great depression, similar situations developed, although apparently to a less marked degree.[13]

When a company is heavily in debt to bankers, the latter may play an important role in the company's affairs for a considerable period. That is, the power acquired is translated into a significant degree of decision-making. A committee of banking (and perhaps merchandise) creditors may take charge of financial decisions, sometimes select a new chief executive and perhaps other officers, and initiate policies aiming at internal reorganization and financial retrenchment. Such was the case, for example, in General Motors in 1910 and Goodyear Tire and Rubber in 1921. In the funding of the short-term debt of a company in temporary financial difficulties a few years ago, the underwriters of the new bond issue secured an agreement with the borrowing firm that the successors to the two chief men in management must be approved by the bankers floating the issue.[14] Subsequent borrowing by the company, however, was not attended by any such provision.

Reorganization has proved a fruitful occasion for acquisi-

[11] Maintenance of banker power in the 1910 episode was ensured for five years by the setting up of a voting trust. For information on these two periods in General Motors' history, see L. H. Seltzer, *A Financial History of the American Automobile Industry*, pp. 162 ff., 196 ff. See also p. 175, above.

[12] See Hugh Allen, *The House of Goodyear*, Chap. 3; H. and R. Wolf, *Rubber*, pp. 447-53; *Fortune*, November 1932, p. 104.

[13] Large corporations, in general, entered the depression of the thirties in a sounder working-capital position than in the 1921 depression. It was not impaired cash position, large current indebtedness, or an excess of inventory, but loss of earning power and unsound capitalization that brought on financial difficulties in the thirties. These weaknesses led frequently to receivership and reorganization.

[14] See the prospectus for a bond issue of Cleveland-Cliffs Iron Company dated Dec. 10, 1935. This case is discussed at some length in TNEC Hearings, Pt. 24, pp. 12462 ff.

tion of power by financial interests. This has been particularly true of the railroads. The wholesale railroad reorganizations of the 1890's resulted in putting a banking group, particularly J. P. Morgan and Company, into an extremely strong position in a number of important railroads.[15] Later, banking groups were able to acquire, maintain, or enhance their power in relation to particular railroads through the leading roles they played in reorganization proceedings. Very recently, insurance companies, the largest long-term creditors of the railroads, have taken a more important part in railroad reorganizations. Banking and other financial groups have also been able to acquire a great deal of power in the reorganization of other than railroad corporations. Since 1938, however, activities of bankers in reorganization proceedings have been seriously circumscribed by the new Chandler amendments to the bankruptcy law. (We shall say more about this later.)

What has been the nature of bankers' leadership in reorganizations? In the past bankers have played a leading part in arranging the terms of reorganization and the capital structure of the reorganized company, and in selecting the new board of directors and chief executive.[16] There have been

[15] In the reorganizations dominated by Morgan at that time, a voting trust was usually created, with one or more Morgan partners as voting trustees. This was true, for example, of the Northern Pacific, Reading, Erie, Southern, and Chicago Great Western. The last was reorganized in 1909. See Campbell, *The Reorganization of the American Railroad System, 1893-1900*; *Report of the Committee . . . to Investigate the Concentration of Control of Money and Credit*, H. Rept. 1593, 62 Cong. 3 sess., pp. 61-63, 148-50.

[16] The roles played in recent years by bankers and creditor groups during corporate reorganizations have been thoroughly explored by the Securities and Exchange Commission. The Commission had this to say of the role of investment bankers in corporate reorganizations: "Houses of issue and their counsel have served as the focal point for mobilization of security holders in reorganizations. In this respect they have played a role junior to none—not even the management. While their plans and program have almost uniformly been worked out in conjunction with the management of the company and in conformance with its general desires and objectives, they have supplied the initiative and the drive incident to organizing the security holders, mapping out the necessary reorganization procedure, working out the plan of reorganization, and designing the machinery necessary for its consummation. As a consequence, they have been deemed by many to be essential to the reorganization system, for without them there would be

a number of instances in which reorganizations have left particular bankers with a monopoly of future new security issues and, frequently, with a strong voice in management for several years thereafter.[17] In the railroad field, bankers have in some cases been active between and after reorganizations, helping to choose top executives and directors, determining the timing and nature of new security issues, and exercising some approval function with respect to acquisitions of property and the securities of other roads. Here as elsewhere, their leadership has centered around the making of financial decisions and, perhaps to a less extent, the choice of men. They seem to have played a much less important role in operating and traffic matters.[18] Even in financial matters, bankers have co-operated with officers and influential members of the board. It has not been a case of bankers being solely responsible for decisions in these matters.[19]

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no one with comparable ability, resources and interest in the situation who would be able to take the lead and the responsibility for initiating and directing the reorganization process. However that may be, it is true that reorganization of a corporation of substantial size without the assistance of the principal houses of issue is an anomaly in current practice." Securities and Exchange Commission, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Pt. 2 (1937), p. 164. On the general subject of the roles of bankers and creditor groups, see Pts. 1, 2, and 7.

[17] For example, the reorganization of Armour and Company led to banker control of financial and other policies after 1923. N. S. B. Gras and Henrietta Larson, *Casebook in American Business History* (1939), pp. 640, 641-42.

[18] The elder J. P. Morgan, however, was influential in bringing about agreements as to rates and division of territory in the late eighties and nineties. *Investigation of Railroads, Holding Companies, and Affiliated Companies*, Report of the Committee on Interstate Commerce, S. Rept. 1182, Pt. 1, *Railroad Combination in the Eastern Region*, 76 Cong. 3 sess., pp. 16-17; Lewis Corey, *The House of Morgan* (1930), pp. 166 ff., 199.

[19] In general, railroad managements were probably more subservient to associated banking interests 30 or 40 years ago than they have been in recent years. Furthermore, in spite of the power which bankers have acquired over a number of railroads—largely but not wholly as a result of the many reorganizations in the industry—certain roads, especially those with relatively profitable records, have retained considerable independence of management. In the Pennsylvania, which has been characterized by a long period of profitable operation and a succession of able and aggressive managements, there is no question of the dominant and independent position of the management, even in financial matters, although partners in Kuhn, Loeb and Company seem to have worked closely with the company's officers

Other cases of financial influence and leadership. There are other circumstances in which financial groups may find themselves in a position to affect decision-making in particular companies. They are likely to play an important part in the selection of new managements when the control powers of owners are weak. Boards of directors, ordinarily passive in companies dominated by strong chief executives, have been known, on the latter's death or retirement, to turn to bankers for aid or advice in choosing a successor.[20] Since the new management may exercise more or less completely independent discretion from then on, leadership by the financial group in such cases may be limited to choosing the executive—except that the bankers, of course, are likely to become active again if new securities are to be issued or bank loans obtained.

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in many financial matters. See the various volumes of the Wheeler committee, S. Rept. 1182, 76 Cong. 3 sess.

On the other hand, the New York Central represents a case of a successful company in which banker participation in active leadership has been more pronounced. The Morgan-Baker interests have played an important role in the company. Partners of the Morgan firm and, when he was alive, the elder G. F. Baker (of the First National Bank of New York) actively participated in making numerous important decisions, chiefly in financial matters. As an indication of the importance of Baker, who was a large stockholder in his own right, see a letter to him from the chairman of the finance committee in 1925, stating that a matter before the finance committee would be held in abeyance until Baker returned to New York. (S. Rept. 1182, Pt. 3, p. 1669. See, also, the letter reproduced on p. 1670 of the same volume for an indication of Baker's influence in the Lehigh Valley Railroad.) According to *Fortune* (February 1932, pp. 70, 112), representatives of J. P. Morgan and Company and the First National Bank participated in the selection of the president of the New York Central. In this connection, the magazine stated: " 'The interests,' which is to say in modern parlance, the bankers, elect railroad presidents." Although put too strongly, this statement apparently has a substantial element of truth.

In other roads, particularly those which have gone through extensive and frequent reorganizations, the power and active leadership of bankers has been especially marked. A case in point is the Chicago, Milwaukee, and St. Paul, which was in receivership from 1925 to 1928. Evidence indicates a good deal of active leadership by banking groups both before 1925 and after 1928, as well as during the reorganization proceedings. This leadership included the choice of the company's chief executive. See *Investigation of Railroads, Holding Companies, and Affiliated Companies,* Additional Report, S. Rept. 25, Pts. 18-22, 76 Cong. 3 sess., especially Pt. 21.

[20] See, for example, what was said of the railroads, note 19, p. 198, above. See also TNEC Hearings, Pt. 24, p. 12359. See also *Fortune,* January 1935, pp. 69, 70, for two cases in which J. P. Morgan and Company is supposed to have appointed a chief executive.

Investment bankers are in a position to establish intimate relations with a firm when owners of a closely held corporation seek to transfer ownership to the public.[21] Not only may bankers acquire some influence as the price of underwriting, but they may find it easy to maintain that influence subsequently as a result of the weakening of the stockholder interest through diffusion of ownership. Similar factors enter in the case of mergers.[22]

Independent of action by the corporation, financial interest groups may acquire power and wield influence in a company through a variety of familiar devices aimed at securing voting control. Purchase of minority interests, creation of voting trusts, pyramiding of holding company structures, to mention some of the methods, are means used by wealthy individuals and banking houses to acquire influence over particular corporations. Banking houses, as well as individuals, have often bought into one or more companies—either directly or by setting up a holding or investment company. The creation of The United Corporation by the Morgan-Drexel-Bonbright interests is a case in point.[23] Bankers, moreover, have fre-

[21] The influence of J. P. Morgan and Company in the affairs of the New York Central dates from the year 1879, when W. H. Vanderbilt asked the Morgan firm to sell part of his holdings of New York Central stock to the public. (Campbell, *The Reorganization of the American Railroad System, 1893-1900*, p. 146; Corey, *The House of Morgan*, pp. 139-42.) In 1920, to cite another case, the Thorne brothers, until then the dominant interest in Montgomery Ward, sold a large block of stock to J. B. Duke and C. A. Whelan, who shortly afterward sold the stock to a banking group connected with J. P. Morgan and Company and First National Bank of New York. The next president of the company was selected by the bankers. (*Fortune*, January 1935, pp. 69-70.) A similar sale of private holdings to bankers created the Morgan influence in Johns-Manville. *Fortune*, March 1934, p. 84.

[22] The part played by the House of Morgan in the formation of United States Steel Corporation is the best known but by no means the only important case of this sort. Formation of International Harvester in 1902 represents another well-known example. Here also the banking firm was J. P. Morgan and Company. The banking influence was stronger and endured over a longer period in the Steel Corporation than in International Harvester. In the latter company, a dominant minority interest has continued in existence to the present day.

[23] See p. 172, note 38, above. Strategic moves by bankers, as well as others, to acquire influence over large corporations through security dealings and creation of holding companies have been particularly prevalent in the public

quently been involved in security transactions of a type which resulted in giving them a large measure of influence in the affairs of particular corporations.

Extent of decision-making by bankers. In some companies, leadership by a banking group may be said to be exercised regularly, rather than merely on sporadic occasions such as the issuance of new securities, reorganization, or merger. Even in such cases, however, the influence or decision-making of the group is likely to be felt primarily in relation to financial matters, whether the banking interests are represented on the board of directors or not. The bankers may initiate and approve decisions with respect to new issues, offer advice where important financial considerations are involved, and participate with the major executives (and perhaps some directors or the board as a whole) in the approval of expansion programs. In some cases, fairly regular participation in the selection of directors and major executives may be involved. Although bankers do not ordinarily attempt to interfere directly in nonfinancial matters to any considerable extent, except when retrenchment is sought after financial difficulties, their influence on financial policy may of course have substantial repercussions on operating and price decisions.[24] On occasion, appar-

utility field. See, for example, Federal Trade Commission, S. Doc. 92, Pt. 72-A, 70 Cong. 1 sess., especially pp. 75-81.

[24] The emphasis of bankers on solvency and liquidity, regardless of profit and operating criteria, is eloquently illustrated by the following excerpt from a letter from three banking houses to the president of American Telephone and Telegraph, written in 1907, shortly after these houses had become the company's bankers:

"Our interest in the success and prosperity of your company induces us to repeat to you what we have already said, verbally, to your predecessor, Mr. Fish.

"We consider it of vital consequence to the financial welfare of the company that no expenditures should be entered upon in the near future, except such as are absolutely necessary, no matter what the prospective profits on other expenditures may be—the credit of the company being of paramount importance."

This letter, from the files of the Federal Communications Commission, is reproduced in TNEC Hearings, Pt. 23, p. 12160; also in N. R. Danielian, *A. T.&T., The Story of Industrial Conquest* (1939), p. 72.

For a different type of influence from a financial group (in this case operating on prices) involving the sort of financial manipulation by bankers that was all too common during the twenties, see E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress*, pp. 149-56.

ently, bankers have intervened in decisions respecting prices and other non-financial matters, but such influence and decision-making are generally not exercised continuously. Banker interference in non-financial decisions seems to be less extensive today than it was in the first decade of the century.

The main points to be emphasized in this discussion of leadership by financial groups are: (1) the wide variety of types of situations found in practice, (2) the fact that even in the same companies different degrees of leadership have been exercised by bankers at different times, and (3) the fact that "banker control" almost never means anything close to complete assumption of the leadership function by bankers. To say that a company is subject to banker control is to say little more than that some banking group is in a position to exert an influence on decision-making by management or perhaps to participate in some kinds of decision-making itself. Control of the sale of new security issues is not an adequate criterion of the degree of active leadership exercised by a company's bankers. Neither is the extent to which bankers serve on boards of directors. The degree and kind of business leadership involved in "banker control" varies from company to company—and even in the same company with the passage of time. The facts can be ascertained only by a study of individual cases.

To give further concreteness to this discussion, detailed case studies of banking influence in two prominent American companies are presented in the following pages.

BANKER INFLUENCE AND LEADERSHIP IN UNITED STATES STEEL CORPORATION

Both United States Steel Corporation and American Telephone and Telegraph Company are sometimes spoken of as "Morgan companies."[25] There is little question, however, that the degree of power and leadership by the Morgan group has differed greatly in the two cases.

[25] See, for example, National Resources Committee, *The Structure of the American Economy*, Pt. 1, pp. 309-10, which places both companies in the "Morgan-First National" interest grouping.

In the case of the Steel Corporation, a banking group has possessed a great deal of power, and this power has, on various occasions, been translated into something more than a mere influence over financial matters.[26] The elder J. P. Morgan and his firm played the leading part in the formation of the company in 1901.[27] Impressed by the success of committee management in Standard Oil, Morgan was responsible for setting up an executive committee of the board of United States Steel headed by Gary, as well as a finance committee.[28] Final approval of the first board of directors rested with Morgan, who admitted in 1912 that even then no director could be elected over his protest.[29]

In the first decade of the Corporation's history, Morgan ap-

[26] Selection of "Big Steel" for discussion is not meant to imply that this company represents by any means the extreme in banker control. Other examples of strong banker control might be given. The case is chosen because of the importance of the company and the fact that banker influence in this case has already been extensively discussed in print; witness the following statement: "The [Steel] Corporation is the leading example of what is known as 'a Morgan company.' Indeed, considering its size and the fact that the elder Morgan created it, the Corporation may well be called *the* Morgan company." *Fortune*, March 1936, p. 63.

[27] Corey, *The House of Morgan*, Chap. 23; *Money Trust Investigation*, Subcommittee of the House Committee on Banking and Currency (1913), pp. 1025, 1026-27; *United States Steel Corporation*, Hearings before the House Committee on Investigation of United States Steel Corporation, 62 Cong. 1 and 2 sess., p. 204 ff., 1276 ff.; Ida M. Tarbell. *The Life of Elbert H. Gary*, Chap. 5.

[28] The same, p. 127. It is interesting to note that Morgan apparently completely misunderstood the nature and functioning of the top-management committees in the Standard Oil organization. The latter were highly active committees of men who were essentially working partners in the business. The committee members were in a sense owner-managers, who concerned themselves intimately with the operations of the business. The committees set up in United States Steel were largely committees of outsiders. The executive committee, which presumably was to concern itself with operations, was abolished within two years. The finance committee has endured to the present; but it is dominated by outsiders and bankers, and other members of the financial community have always been strongly represented. The company has never had a powerful standing committee of "steel men" in the same way that the old Standard Oil "Trust" had its committees of men who "knew oil"—committees which have their counterparts even today in the various Standard Oil companies in the form of boards of directors and executive committees made up of full-time executives of long experience in the petroleum industry.

[29] *Money Trust Investigation*, pp. 1025-26; Tarbell, *The Life of Elbert H. Gary*, p. 126.

parently was the final authority in a number of major decisions. A labor agreement following a strike in 1901 was signed in his office. In 1909, Gary—by then chairman of the board and of the finance committee—cabled Morgan in Europe for support in opposing a wage reduction in the company's subsidiaries which was being recommended by President Corey and other officials.[80] Gary frequently conferred with Morgan and relied on him for support, particularly in the first few years. The banker was responsible for Gary's becoming chairman of the finance committee in 1907, succeeding G. W. Perkins, a Morgan partner.[81] Purchase of the Tennessee Coal, Iron and Railroad Company in 1907 was in large part inspired by Morgan, despite objections by Gary and Frick.[82] Partners of Morgan and Company served on the board and its standing committees. Needless to say, the raising of new funds was completely controlled by the Morgan group.[83]

[80] The same, pp. 160, 214; Corey, *The House of Morgan*, pp. 279-80; *United States Steel Corporation*, Hearings, 62 Cong. 1 and 2 sess., p. 1568. For Morgan's influence on the Corporation's labor policy, see Tarbell, *The Life of Elbert H. Gary*, Chap. 7, and Corey, *The House of Morgan*, Chap. 24. Several conferences just before the 1901 strike were held in Morgan's office. Tarbell, *The Life of Elbert H. Gary*, p. 158.

[81] The same, pp. 148-49, 190 and Chaps. 6-9; *Money Trust Investigation*, p. 1026.

[82] Morgan's interest apparently arose out of the need of helping a prominent brokerage house in financial difficulties during the 1907 crisis. Actual negotiations were handled by Gary and Frick. (See *United States Steel Corporation*, Hearings, 62 Cong. 1 and 2 sess., pp. 129 ff., 937, 1093; Corey, *The House of Morgan*, pp. 345-46; Tarbell, *The Life of Elbert H. Gary*, pp. 196 ff.) The Corporation's finance committee met a number of times during the negotiations—in Morgan's library. Though not a member of the committee, Morgan was apparently present at these meetings. (*United States Steel Corporation*, Hearings, 62 Cong. 1 and 2 sess., p. 1425.) Gary yielded to Morgan also in the leasing of the Great Northern's ore lands. Tarbell, *The Life of Elbert H. Gary*, p. 236.

[83] Morgan influence and leadership showed itself in other ways, also. In 1903, the finance committee was prepared to pass the dividend on the preferred stock, "and it was only the most earnest possible urging on Mr. Morgan's part that caused the committee to go on and declare that dividend and not pass it." (Testimony of G. W. Perkins, in *United States Steel Corporation*, Hearings, 62 Cong. 1 and 2 sess., p. 1585.) At about the same time, Gary prevailed on Morgan, after a long argument, to permit the passing of the dividend on the common. As Miss Tarbell tells the story, though Morgan gave in to Gary and the common dividend was omitted, it was up to the banker to decide. (Tarbell, *The Life of Elbert H.*

It would be a grave error, however, to assume that this active and extensive control by Morgan and his partners, even in the Corporation's earlier years, meant full and complete assumption of the leadership function.[34] Gary's power in the company steadily grew, and in many matters he was able to impose his will on other members of the board and on the other executives.[35] This would not have been possible of course without the explicit or tacit approval of Morgan. The company's policy of stable prices and friendly relations with competitors was clearly Gary's work. There is little evidence that the financial group interfered to any great extent in operating matters, and this became increasingly true with the passing years. At the time of Gary's death in 1927, he was indubitably the dominant figure in the corporation. As in other corporations, many important operating decisions were made by subordinates. Such decentralization on the operating side was probably accentuated by the board's interest in purely financial affairs and by Gary's leanings toward broader questions of competitive and public relations and legal and financial matters.[36] The finance committee of the board, of which

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Gary, pp. 170-71.) It should be noted that Morgan was not a member of the finance committee.

[34] In this connection, the following incident is of interest. In June 1901, shortly after the formation of the Steel Corporation, the Pennsylvania Railroad purchased the controlling interest in two independent steel companies. This was done by the railroad apparently to protect itself against the United States Steel Corporation. The securities were purchased through E. B. Morris (a trustee under the will of A. J. Drexel) and Drexel and Co., "by that time a mere branch" of J. P. Morgan and Co. The Wheeler committee in analyzing this transaction stated: "There are several circumstances surrounding these steel company purchases which are confusing and suggest that perhaps Morgan control of the Steel Corporation's policies at this time was not as close as has been generally thought." S. Rept. 1182, Pt. 1, 76 Cong. 3 sess., pp. 52-53.

[35] See Tarbell, *The Life of Elbert H. Gary*, especially Chaps. 6, 8, and pp. 218-19; Arundel Cotter, *United States Steel: A Corporation with a Soul*, especially pp. 3, 92-93. Gary was chairman of the executive committee, 1901-03; chairman of the board from 1903 on; and chairman of the finance committee after 1907.

[36] See *Fortune*, March 1936, p. 63; H. N. Casson, *The Romance of Steel* (1907), pp. 213-14. From the internal reorganization of the company undertaken after Gary's death, one would gather that on the operating side the diffusion and overlapping of responsibility among the operating executives had gone so far as seriously to impair operating efficiency.

some partners of the Morgan firm have always been members, exercised some independent approval function but in general seems to have followed Gary's lead. Individual members of the finance committee, particularly the Morgan partners, undoubtedly participated in the making of many major decisions, especially on the financial side. Gary, however, seems to have been largely responsible for the company's labor policies, especially after the first few years.[37]

The internal reorganization of the Corporation after Gary's death in 1927 was undertaken by Myron Taylor, who was apparently chosen for the job by the Morgan group. For several years after 1927, a "triumvirate" of Taylor, J. P. Morgan (who became chairman of the board on Gary's death), and James Farrell (president from 1910 to 1932) was said to be in charge of the company's affairs. Taylor, however, was the chief figure in the company from the end of the twenties until his resignation in 1938, and the Corporation's extensive internal reorganization program was carried out under his direction.[38] Morgan partners on the finance committee undoubtedly played a role of some importance, both as advisers and in approving major decisions. The entire finance committee seems to be somewhat more active than the typical standing committee of the board in most large corporations. The Corporation's famous contract with the Steel Workers Organizing Committee in 1937 was apparently Taylor's work, although approval of the board had to be secured.[39] Who was responsible for the choice of the three men to take over the

[37] See Tarbell, *The Life of Elbert H. Gary*, Chap. 11; Cotter, *United States Steel: A Corporation with a Soul*, pp. 4, 139, 246 ff. Neither of these authors can be considered unbiased in their discussion of controversial issues, including Gary's and the Corporation's earlier attitudes toward wages, hours, and union organization.

[38] M. C. Taylor, *Ten Years of Steel* (address before the annual stockholders' meeting, April 1938); *Fortune*, August 1931, p. 121; June 1936, p. 113; March 1940, pp. 64, 67. Taylor was chairman of the finance committee from 1927 to 1932, when he succeeded Morgan as chairman of the board. Farrell held the title of "chief executive officer" from 1927 to 1932, after which this title passed to Taylor. The latter gave up the chairmanship of the finance committee in 1933.

[39] See Taylor, *Ten Years of Steel*, pp. 40 ff.

leadership of the corporation when Taylor resigned is not known. It may be surmised that selection of these men represented a joint decision of Taylor and a few key directors, including one or more of the Morgan directors, subject to more or less automatic approval of the board as a whole. Since 1938, the situation in the Steel Corporation might be characterized as one in which strong potential power by a banking group still exists but in which active leadership rests with the executive group, subject to some veto power by a relatively strong finance committee. There is no question that operating policies—including decisions as to price policy—are determined by the executive group, particularly by the president (who is "the chief administrative officer") and his principal subordinates.

"Banker control" in this company, then, has meant a strong and continuing influence, stronger at some times than at others, and a varying degree of participation in the process of decision-making. Active leadership by the banking group was most in evidence in the early years of the corporation's history, and again after Gary's death, when the continuity of a successful management was broken.[40] The extent of banking influence in the future will probably depend on the independence displayed by the top management group and the future profitability of the company's operations.

AMERICAN TELEPHONE AND TELEGRAPH COMPANY: A CASE OF DECLINING BANKER INFLUENCE

American Telephone and Telegraph is sometimes also classed as a "Morgan company." The Morgan firm has for many years regularly headed the syndicates underwriting the public sale of new security issues of the parent and subsidiary companies. Members of the "Morgan-First National" group have served on the board of directors for more than a third of a century, although at present it is the company's policy not to

[40] Apparently Gary failed to prepare any one to take his place. It is probably significant that two additional Morgan partners, as well as Walter Gifford of American Telephone and Telegraph Company, were elected to the board after Gary's death.

permit sellers of securities on the board.[41] There is no question, further, that for a number of years, particularly beginning about 1906, a group of bankers was able to exert a strong influence on the company's management. In some cases, this influence may have been tantamount to the exercise of a considerable degree of active leadership. Nonetheless, there seems to be little doubt that today practically all elements of the leadership function (subject to some qualification because of government regulation) rest with the company's management. This has probably been the situation since 1920 or earlier.

The history of the Telephone Company affords an illuminating case study of the way in which the power and leadership of various interest groups associated with a firm may change during a company's evolution from small beginnings to one of today's giant corporations.[42]

During the first four decades of the company's growth, from 1875 to about the time of the war of 1914-18, two main lines of development were taking place in the evolution of control over the company's affairs. First, management of the company came fairly rapidly into the hands of officers and directors who were not important stockholders in their own right. Between 1881 and 1900, the number of stockholders

[41] By the "Morgan-First National" group we mean partners of J. P. Morgan and Company (and, for the last few years, also officers of Morgan, Stanley and Company) and officers of the First National Bank of New York. To these should be added, particularly before, say, 1920, the representatives of certain other closely affiliated financial institutions. Kidder, Peabody and Company, a prominent New England banking firm, had close relations with the Telephone Company until the early thirties and was prominently associated with the Morgan group in the sale of the company's securities. See TNEC Hearings, Pt. 23.

The rule against sellers of securities sitting on the board would not now exclude representatives of either the First National Bank or of J. P. Morgan and Company, neither of which has been able to engage in the underwriting or sale of securities since 1933. The company's rule would, however, exclude members of Morgan, Stanley and Company, which inherited the investment banking business of J. P. Morgan and Company.

[42] The analysis of this and the following paragraphs refers to American Telephone and Telegraph and its predecessor companies. For a corporate history of the company, see Federal Communications Commission, *Investigation of the Telephone Industry in the United States*, H. Doc. 340, 76 Cong. 1 sess., pp. 1-10; also Danielian, *A.T.&T., The Story of Industrial Conquest*, pp. 7-14.

increased from less than 600 to more than 6,000, and the holdings of officers and directors became a steadily decreasing percentage of the total outstanding stock.[43] However, even in the period 1900-10, important stockholders seem to have had some influence in the company's affairs; a relatively small group owned a substantial minority of the stock; and the directors played a more important role in the company's affairs than is generally true today. After 1910, the tendencies toward professionalization of management, diffusion of ownership, and a weakening of the influence of the stockholding group continued and were accentuated.[44] The power and independence of management steadily increased and the influence of the stockholders decreased. Gradually, also, it would seem, particularly from about 1910 on, the influence of the executive group increased relative to that of the directors. Today, the president selects the directors, rather than the reverse.[45]

The second line of development in the evolution of control in the Telephone Company has to do with the major shifts in power which have taken place among the important outside interests connected with the company. It is here that we meet the problem of banker control. As the company's need for new capital grew, the ability to wield a strong influence over management decisions shifted to the groups able to supply the needed funds.

In the earlier years of the company's history, the need for new capital led to a rapid increase in the number of stockholders. At an early stage in the company's development, leadership passed from the original promoters and financial backers to a wider group of New England capitalists. Although the largest stockholders yielded more and more leader-

[43] H. Doc. 340, 76 Cong. 1 sess., pp. 86-87; TNEC Hearings, Pt. 23, pp. 12118-24.

[44] See H. Doc. 340, 76 Cong. 1 sess., pp. 87 ff.; TNEC Hearings, Pt. 23, pp. 12118-24, 12132-33, 12157 ff.; FCC, *Telephone Investigation: Special Investigation Docket No. 1*, Rept. 62 (*Control of American Telephone and Telegraph Company*), p. 24.

[45] H. Doc. 340, 76 Cong. 1 sess., pp. 98-100; *Telephone Investigation: Special Investigation Docket No. 1*, Rept. 62, pp. 116-17.

ship to the management, which came to hold only a very small percentage of the outstanding stock, this New England group of capitalists was the dominant outside interest until shortly after 1900.[46]

From about 1900 on, after the expiration of the original Bell patents and with increasing competition from independent companies, the Telephone Company found New England's resources inadequate for the expansion program that was planned. It turned, therefore, to New York for further financial aid.[47]

Between 1900 and 1907, various financial interests sought to acquire a strong position in the telephone industry.[48] In 1902, G. F. Baker of the First National Bank of New York acquired a substantial stock interest in American Telephone on behalf of himself and others, including the Morgan firm. Two members of the group were elected to the board; another member was already a director. Other banking houses also sought to become the company's bankers and to float its securities. In the meantime, numerous groups were seeking to gain

[46] See H. Doc. 340, 76 Cong. 1 sess., pp. 83-87.

[47] The same, pp. 87, 102; TNEC Hearings, Pt. 23, pp. 11834, 11848. "When the Bell System's monopoly control over the industry again was challenged, after expiration of the basic Bell patents, by the rapid rise of independent companies, Bell's financial requirements again became the critical factor, and its alternatives apparently were either to accept a minor role in the telephone industry or to gain access to a stronger source of investment capital." (H. Doc. 340, 76 Cong. 1 sess., p. 102.)

[48] American Telephone and Telegraph Company has, in a letter to the author, taken issue with certain portions of the account given in the following pages of the company's relations with its bankers in the several years following 1906. In particular, it disputes the accuracy of the interpretation presented by the FCC in its report on *Investigation of the Telephone Industry*, which I have cited often in these footnotes. The company's official comments on the FCC's treatment of this period in the company's history will be found in its *Telephone Investigation, 1935-1937: Comments Submitted to the Federal Communications Commission*, especially Comments—Pamphlets No. 9, pp. 7-10, and No. 10, pp. 4-6; also in the company's *Brief of Bell System Companies on Commissioner Walker's Proposed Report on the Telephone Investigation*, pp. 28-29. I have carefully examined the material presented by both the FCC and the company and have tried to present here an impartial analysis of what seems to have occurred. I have cited the FCC report as a convenient source for many of the facts noted, but the interpretation throughout this discussion is my own, not necessarily the Commission's.

a position of power in the telephone field, either through the Bell company or through organizing its competitors, and to combine one of these telephone systems with one of the two large telegraph companies.[49]

By 1907, the Morgan-Baker group had prevailed over the other financial interests seeking a voice in the Telephone Company's affairs. Through the urging of one of the directors associated with Baker, the president and the executive committee finally agreed in 1906 to the sale of a large convertible bond issue on a non-competitive basis. The Morgan firm's leadership in this syndicate gave it the leading position in the public sale of the company's bonds, and this position was retained in the years that followed.[50]

In 1907, a committee of directors was appointed to study the possibilities of internal reorganization. Within a short period, the committee's recommendations were made and adopted, the president resigned, and the composition of the executive committee was changed to give greater representation to the bankers. The new president was Theodore Vail, a director since 1902, who had worked with members of the banking group.[51]

[49] See H. Doc. 340, 76 Cong. 1 sess., pp. 87-92, 102-03; TNEC Hearings, Pt. 23, pp. 11837-38. See also the company's *Telephone Investigation, 1935-1937*, Comments—Pamphlet No. 9, p. 7.

[50] See H. Doc. 340, 76 Cong. 1 sess., pp. 89-92, 432-35. Strictly speaking, the Morgan firm did not lead in the 1906 financing. The arrangements to purchase the bonds were made jointly by J. P. Morgan; Kuhn, Loeb; Kidder, Peabody; and Baring Brothers. (TNEC Hearings, Pt. 23, pp. 11847, 12142-47.) In the later issues, the Morgan firm seems to have been the leader, but Kidder, Peabody, with its New England connections, also played an important role until the 1930's. There is no question that J. P. Morgan and Company and, from 1935 on, Morgan, Stanley and Company came to be the leading bankers in the company's financing. See, for example, TNEC Hearings, Pt. 23, pp. 11930 ff.

[51] H. Doc. 340, 76 Cong. 1 sess., pp. 92-93. Vail had been at one time general manager of the predecessor American Bell Telephone Company, resigning in 1885. During the two following years he was president of American Telephone and Telegraph, when this company was merely the long-lines subsidiary in the Bell system. Vail severed his connection with the Bell system in 1887. He was elected a director of the parent company in 1902. At first, he apparently represented the Mackay holdings, but then or later he became closely associated with the banking group. Vail was apparently also offered the presidency of the American Company in 1900,

In the years immediately following 1907, the bankers were clearly in a position to exert a strong influence. The number of bankers on the board was increased. We have already spoken of the change in the executive committee. Vail conferred with his banking associates and sought their counsel on various matters, including the selection of directors.[52] Further, in 1907, after the convertible bond agreement, the bankers wrote to the company's president cautioning against any except "absolutely necessary" expenditures. How far the suggestion was followed is not known.[53]

Vail was a man of independence and ability; and, for this and other reasons (including the strength of its new financial connections), the company prospered. Though Vail's connections with the bankers were close, he was able to and did exercise an independent judgment. Steadily the executive group headed by Vail came to dominate the organization, and major decisions were apparently made by them with routine approval of both the executive committee and the board. On financial matters, the banking interests were probably more active.[54] But Vail selected his own successor, and there is no

but on that occasion he declined. See FCC, *Telephone Investigation: Special Investigation Docket No. 1*, Rept. 67 (*Financial Control of the Telephone Industry*), pp. 85-86, 110; A. B. Paine, *In One Man's Life: Being Chapters from the . . . Career of Theodore N. Vail* (1921), especially pp. 229 ff; A. T. and T., *Telephone Investigation, 1935-1937*, Comments—Pamphlet No. 10, p. 6.

[52] H. Doc. 340, 76 Cong. 1 sess., pp. 98-99. The company has denied that the known facts during this period indicate any substantial degree of banking influence over either the board or the new president, T. N. Vail. See the company's *Telephone Investigation, 1935-37*, Comments—Pamphlets No. 9, pp. 8-10, and No. 10, pp. 4-6.

[53] See excerpt of letter, p. 201, above. Danielian states that the bankers did exercise active control over capital expenditures. (See *A.T.&T.*, *The Story of Industrial Conquest*, p. 72.) Engineering expenditures were apparently cut shortly thereafter. (The same, p. 102.) According to the FCC, Fish, Vail's predecessor as president, and Crane, a prominent director, had previously entered into an informal agreement with the bankers to follow the latter's suggestions as to the use of the borrowed money. (*Telephone Investigation: Special Investigation Docket No. 1*, Rept. 67, pp. 154-55.) President Fish did write to the company's subsidiaries urging economy for the time being. (The same, p. 161.) This may or may not have been due to the bankers' urgings.

[54] In 1915, and again in 1916, Vail was asked by J. P. Morgan and Company to participate in a loan to the Allies. As late as Nov. 4, 1916,

question that this procedure has been followed by the chief executives who came after him.[55] Obviously the board, and the bankers on the board, *could* object to the president's decisions on this and other matters. But their powers of veto and approval became increasingly a passive, potential element. With the advice of the more active directors, the president selects candidates to fill vacancies on the board. Under the regime of Walter Gifford, president since 1925, there is little question that leadership is practically entirely in the hands of himself and his major executives.

The Morgan group has continued to head the public sale of the company's bonds.[56] In doing so, they have undoubtedly participated in decision-making on certain financial matters. Since 1938, however, several issues have been placed privately without the intervention of any banking group. And in 1941, for the first time in 35 years or more, the company opened a bond issue to competitive bidding.[57]

In this company, then, banker control meant a really strong influence and probably some active leadership for per-

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Vail sent a letter to T. W. Lamont of the Morgan firm refusing to recommend to his executive committee participation in a British loan to the extent of 5 million dollars. On Dec. 14, 1916, however, the company participated to the extent of 20 millions in a British loan. Approval of the transaction by the executive committee was made after the event. See TNEC Hearings, Pt. 23, pp. 12190-95; FCC, *Telephone Investigation: Special Investigation Docket No. 1*, Rept. 62, pp. 76-81.

[55] See H. Doc. 340, 76 Cong. 1 sess., pp. 100-01; also *Telephone Investigation: Special Investigation Docket No. 1*, Rept. 62, p. 108; and Danielian, *A.T.&T., The Story of Industrial Conquest*, pp. 83-85, 88.

[56] A convertible bond issue in 1929 and another in 1941 were sold directly to the stockholders and were not underwritten by bankers. In 1941 a bond issue was opened to competitive bidding. New stock issues of the parent company have generally been sold directly to stockholders without the intervention of bankers. Some issues of subsidiaries were sold, at least before 1920, through syndicates not headed by Morgan. (TNEC Hearings, Pt. 23, p. 12209.) Between 1923 and 1936, however, bond issues of the subsidiary companies, with one minor exception, were handled by syndicates headed by Morgan. H. Doc. 340, 76 Cong. 1 sess., pp. 438-39.

[57] See *New York Times*, Jan. 3, 1939, Sept. 23, 1939, and Nov. 28, 1940, for mention of issues placed privately. Two of the three issues mentioned in these references were those of subsidiary companies. Morgan, Stanley and Company headed a banking group bidding for the issue opened to competitive bidding in 1941, but the successful bidders were a group of insurance companies. See *New York Times*, Sept. 30, 1941.

haps a decade—and coincided with a period of rapid expansion when the company was urgently in need of new capital. Increasingly, however, the executive group came to be independent, and the power of the bankers, though it remained to some extent, tended to decline and to mean less and less participation in decision-making. Though the present management had its genesis in the period of greatest banking influence, it must today be considered an independent group, operating in an environment in which bankers make up a part, but only a part, of the totality of influences of which management must always take cognizance.

TENDENCIES UNDERMINING THE POWER OF BANKERS

Although it is seldom safe to generalize about tendencies which have had little more than a decade in which to show themselves, it is difficult to believe that financial groups, particularly bankers, will again possess the degree of power which they enjoyed between 1890 and the beginning of the depression of the thirties. Since 1930, the degree of economic power possessed by banks and bankers in the business community has declined significantly, and it has become more difficult for bankers to translate the power that they have into participation in the leadership function. Investment bankers, in particular, have suffered a lessening in influence, but the tendency is also evident in the commercial banking field.

A number of developments help to explain the loss of influence by banks and bankers. First is the increased independence and power of the executive group in large successful corporations. This development of course had its beginnings long before 1929. A strong and able management in a large, prosperous company can increase its power not only at the expense of stockholders but also at the expense of associated banking interests, particularly if the corporation becomes self-sufficient financially and needs have little further recourse to the capital markets. During the 1920's, many corporations did achieve a considerable degree of financial self-sufficiency—partly through the flotation of equity securities at favorable prices and partly through the reinvestment of earnings. In

many successful corporations, management has become relatively independent, although a particular banking house was at one time very influential in the company's affairs and the banking firm continues to have first call on the company's banking business. Even when management can go its own course, however, executives may seek the advice of bankers, and the latter may take some part in formulating major financial decisions.

The increased financial self-sufficiency of successful large corporations has lessened their dependence on commercial banks as well as investment bankers. The marked downward trend in the commercial loans of banks is well known.[58] Corporate managements, on their side, are more conservative in their financial policies than they were before 1921. With the decline in dependence on commercial bank loans, there is less chance for large firms to become subject to marked banker influence through temporary financial embarrassment. This partial loss of a source of power by commercial banks, however, is offset in part by the powers that they have acquired through acting as representatives of large estates and trust accounts—and perhaps also through their purchases of the bonds and notes of large firms.

The second set of factors tending to lessen the power of bankers was associated with the events and characteristics of the great depression and operated to weaken the control which investment bankers had long held over the capital markets. Involved here were both a decline in the demand for investable funds and a serious weakening in the control by investment bankers over the supply of those funds. The halt in the merger movement of the twenties and the reduced rate of expansion in the economic system after 1929 led to a sharp decline in the demand for both new capital and the services of investment bankers. This decline in demand was particularly marked among the larger corporations and was only partially offset by the gradual increase in demand, after 1934, for the services of bankers in the sale of refunding issues.

[58] See, for example, TNEC Hearings, Pt. 9, pp. 3746 ff.

At the same time that the demand for their services has declined, investment bankers have found their control over the supply of investment capital seriously impaired. Since the middle of the thirties, insurance companies and other financial institutions have competed vigorously with investment bankers for new bond issues. An increasing fraction of new security issues has been placed privately with financial institutions, chiefly insurance companies, without the need for underwriting or public sale and usually without the intermediation of investment bankers.[59] The availability of funds from other sources has strengthened the hand of management and made corporation executives more independent of the investment banking community than they had been before. At the same time, the strength of the investment bankers *vis-à-vis* other members of the business and financial community has declined. Thus both demand and supply factors in the capital market have tended to weaken the influence of investment bankers.

On the other hand, the influence of insurance companies has increased. Under their control is a large and increasingly important fraction of the total supply of investable funds available to industry.[60] Their purchase of securities directly from issuing corporations, individual insurance companies frequently taking from a quarter to all of an entire issue, has undoubtedly increased their influence with the borrowing corporations. Further, insurance companies are taking a more active part in corporate reorganizations, and this tendency has been strengthened by recent legislation and court decisions curtailing the activities of bankers and limiting the rights of stockholders in reorganizations.[61]

[59] See, for example, SEC, annual reports for the years ending June 30, 1936, pp. 34-35, 115; June 30, 1937, pp. 150-51; also later reports for more recent data; *New York Times*, Sept. 18, 1938, Jan. 3 and Mar. 5, 1939; TNEC Hearings, Pt. 9, pp. 3815-18; TNEC, *Study of Legal Reserve Life Insurance Companies*, Monograph No. 28, p. 360.

Commercial banks have also been large purchasers of corporate fixed-income securities, particularly of the shorter maturities. Such securities have been bought both from banking syndicates making public offerings and directly from the issuing corporations in the case of private placements.

[60] See TNEC Hearings, Pt. 9, pp. 3735-39; Pt. 10A, pp. 92-95, 125 ff.; TNEC, Monograph No. 28, Sec. 2 and pp. 363-65.

[61] See *Investigation of Railroads, Holding Companies, and Affiliated*

The most important development leading to a decline in banker influence has been government regulation, particularly recent regulation aimed at financial practices in various fields. Through congressional legislation and the work of administrative agencies, the power and activities of bankers have been restricted in numerous ways since 1933.

The Banking Act of 1933 brought about a formal separation of commercial and investment banking. The loss of their investment banking affiliates weakened the power of the largest commercial banks; old alliances and alignments in the banking field were destroyed or seriously modified; and in the changes that were made necessary new competition was injected into investment banking.[62] Some of the divorcement of investment and commercial banking, though legally complete, was in part nominal, but on the whole the results of the separation were significant. The same act also placed new restrictions on private bankers.

The Banking Act of 1935 caused an elimination of interlocking bank directorates. This measure, though probably of only minor significance, may have weakened somewhat the close ties existing among some banks.

The Securities Act of 1933 and the Securities Exchange Act of 1934 both had important consequences for the banking community. The former placed increased responsibilities on underwriters and otherwise limited their freedom of action in the sale of new security issues. The act of 1934 limited, directly or indirectly, the ways in which bankers could profit

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Companies, S. Rept. 25, Pt. 2, 76 Cong. 1 sess.; TNEC Hearings, Pt. 28, pp. 15573-77; TNEC, Monograph No. 28, p. 7. See also TNEC Hearings, Pt. 28, pp. 15288-95, for another example of active leadership by insurance companies in a railroad reorganization.

There has been a tendency in recent years to give greater recognition to the claims of creditors in the order of their legal and contractual priority and to eliminate the claims of stockholders in cases in which no equity remains after creditors' claims are satisfied. This type of treatment has been steadfastly urged by the SEC. (See the Commission's annual report for the years ending June 30, 1940, pp. 65-69, 1941, p. 47; and 1942, p. 27.) One result has been to strengthen the position of insurance companies as important holders of senior securities.

[62] For a study of some of the realignments made necessary by the Banking Act of 1933, see TNEC Hearings, Pts. 22-24.

from dealings in securities and from their corporate connections. Both measures directed the unblinking spotlight of compulsory disclosure on, among other things, various aspects of the relations between large corporations and their bankers.[63]

Drastic curbs on the power and activities of bankers emerged out of the public utility legislation of 1935. The "death sentence" provisions of the Public Utility Holding Company Act required the Securities and Exchange Commission to undo much of what numerous bankers and others had done in the building up of holding company systems. The breakdown and integration of these systems are under the supervision and control of the Commission. The latter also has important powers of control over various financial activities of the holding company systems subject to regulation, including the issuance of new securities, the acquisition of securities or assets of another company, and the payment of dividends.[64] Under its new powers, the Commission has forced on the public utility industry competitive bidding by bankers for new security issues, thus seriously impairing long-established banking connections. The Commission's earlier "arm's length bargaining rule" had had a similar effect.[65] Further, bankers may

[63] See the provisions of these two acts (48 Stat. 74 and 48 Stat. 881); also annual reports of the Securities and Exchange Commission; and S. Rept. 1455, 73 Cong. 2 sess., pp. 150-53.

[64] See Public Utility Holding Company Act of 1935 (49 Stat. 803, Title I, Secs. 6-12); also the annual reports of the SEC, which contain a good deal of material on the administration of these provisions. The Interstate Commerce Commission has possessed regulatory power over financial affairs of the railroads since 1920, but exercise of this power does not seem to have seriously curbed the influence of bankers in the railroad field—at least, not until very recently.

[65] The competitive bidding rule is the Commission's Rule U-50 under the Holding Company Act and became effective in May 1941. (See *Holding Company Act, Release No. 2676*, Apr. 8, 1941; also annual report of the SEC for year ending June 30, 1941, pp. 98-102.) The "arm's length bargaining" regulation (Rule U-12F-2) was in effect from December 1938 to May 1941. (See *Holding Company Act, Release No. 2676*, pp. 10-11.) The latter rule was applied, for example, to forbid the receiving of underwriting and management fees by Morgan, Stanley and Company in the sale of securities of subsidiaries of Commonwealth and Southern and Columbia Gas and Electric, members of the United Corporation System. The relations between first, Morgan, Stanley and J. P. Morgan and Company, secondly, between the latter and The United Corporation, and thirdly, between United

not now serve as officers or directors of either holding companies subject to regulation by the SEC or of operating utili ties under the jurisdiction of the Federal Power Commission, except as authorized by the commissions concerned. The SEC also has extensive powers over the reorganization of public utility holding companies.

Recent federal revision of the laws pertaining to bankruptcy and corporate reorganization has further circumscribed the powers of bankers in a field in which an extreme degree of banker control has been common. The Chandler Amendments to the federal Bankruptcy Act have hit at the power of bankers in the reorganization of corporations other than railroads.[66] One purpose of Chapter X of these amendments "is to reduce the role of banking groups in reorganizations to that of offering suggestions to the trustees and judges who really draw the plans," instead of permitting the bankers to control reorganization proceedings, as they have so frequently done in the past. In good part, public agencies and their representatives take over the role formerly played by bankers, and here again, the SEC has come to exercise an important degree of influence over corporate activities.[67]

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and the holding companies mentioned were held to be sufficiently close so that there was likely to have been an absence of arm's-length bargaining between the underwriter and borrower. See, for example, the Commission's findings and opinion in the Dayton Power and Light case (SEC, *Holding Company Act, Release No. 2654*, Mar. 28, 1941). See also annual reports of the SEC for the years ending June 30: 1939, p. 83; 1940, pp. 33-35.

The principle of competitive bidding has made some headway in other fields—for example, the railroad and telephone industries—over which the SEC has no jurisdiction in such matters. (See *New York Times*, Sept. 21, 1941, and *Fortune*, September 1939, p. 112.) In May 1944, the ICC announced that railroad securities, with certain exceptions, must from that time on be sold through competitive bidding. *New York Times*, May 11, 1944.

[66] These amendments were enacted in 1938. (See 52 Stat. 840.) Chap. 10, the relevant part of these amendments for our purposes, replaces the earlier Sec. 77B and applies to reorganizations of corporations with complicated financial structures. Railroads are not affected by Chap. 10.

[67] See P. M. O'Leary, "The Role of Banking Groups in Corporate Reorganizations," *American Economic Review*, Vol. 29 (1939), pp. 339-44. The SEC's influence in this connection is important even though, in general, its functions under Chap. 10 are advisory in nature. For a summary of the Commission's activities in recent corporate reorganizations, see its annual reports beginning with the one for the year ending June 30, 1939.

The Interstate Commerce Commission has been given increased powers over the reorganization of railroad corporations. Although the ICC had some control over the financial operations of the carriers from 1920 on, including the power to veto new security issues, actually its control over reorganization proceedings was extremely limited.[68] This situation was changed in 1933. Under Section 77 of the Bankruptcy Act, passed in that year, particularly after strengthening amendments added in 1935, the ICC was given a controlling voice in railroad reorganizations.[69] The Commission must approve plans to be submitted to the parties at interest, and it can formulate its own plans (subject, of course, to approval by the courts); it must approve trustees appointed by the courts; it has the power to regulate the activities of protective committees. Between these new powers of the ICC, on the one hand, and the existence of the Reconstruction Finance Corporation as a powerful creditor of the railroads, on the other, the strength of bankers in railroad reorganizations has been materially weakened.

Specific mention must be made of the activities of the RFC, which has become an extremely important supplier of funds to private business. In 1938, it was said that: "For the time being the great railroad banker is the Reconstruction Finance Corporation."[70] In supplying funds, the RFC has imposed condi-

[68] See I. L. Sharfman, *The Interstate Commerce Commission*, Pt. 3-A, pp. 578 ff. Thus in the famous St. Paul reorganization of 1925-28, the Commission was moved for reasons of expediency to approve securities to be issued although it seriously questioned the soundness of the plan. See *Chicago, Milwaukee and St. Paul Reorganization*, 131 ICC 673, especially 694-96; *Investigation of Railroads, Holding Companies, and Affiliated Companies*, Additional Report, S. Rept. 25, 76 Cong. 3 sess., Pt. 22, p. 7.

[69] This statement holds strictly only for roads which reorganize under Sec. 77 and does not apply to equity receiverships. Most of the important roads now in process of reorganization are proceeding under the provisions of Sec. 77. (See the recent annual reports of the ICC, including *56th Annual Report of the ICC*, 1942, pp. 190-91; also *Investigation of Railroads, Holding Companies, and Affiliated Companies*, Additional Report, S. Rept. 25, 76 Cong. 1 sess., Pt. 6.) For a summary of the Commission's enlarged powers in reorganizations, see its annual report for 1933, p. 22 and for 1935, pp. 20-22.

[70] *52nd Annual Report of the Interstate Commerce Commission*, 1938, pp. 11-12.

tions on the borrowers which frequently amount to the partial assumption of the leadership function. In this way the RFC has become a powerful force in numerous situations in which it has had to give financial aid—situations, it might be noted, in which formerly bankers had a relatively free hand. During the Second World War, the financing activities of the RFC and its subsidiaries have been tremendously expanded, and the federal government has become the creditor or owner of a substantial share of American industry. Through its role as wartime banker to industry, the government has obtained tremendous potential power which it may or may not choose to use in the years after the war.

The general effect of the various tendencies discussed in this section has been to weaken to some degree the influence in the American economy of the entire financial community. One should not, however, exaggerate the extent of this decline in influence. Some financial groups have suffered more than others. And banks and bankers, though they may not now possess the power that they once did, still form a highly important part of the institutional environment conditioning the exercise of business leadership.

Of the financial groups, investment bankers have suffered the greatest loss of power, but at least one type of financial institution, the large insurance company, has enjoyed an increase in influence. For the financial community as a whole, however, there has been a loss of influence—and a lessening in the ability of financial groups to participate in the exercise of business leadership in the large corporation. For this change, government regulation is chiefly, though not wholly, responsible. It may be ventured that, whatever the outcome of the tragic conflict engulfing the world as this is written, the federal government will continue to intervene actively in the functioning of the American economy. The relative strength of the various pressure groups may change, and with it the direction which government control may take. But the absence of regulation within which financial groups built up the power they enjoyed between 1890 and 1930 is not likely to return.

CHAPTER X

THE ROLE OF GOVERNMENT

Management, stockholders, and financial groups have in the past played by far the leading roles in the exercise of business leadership. In recent years, however, the power and influence of government have grown tremendously. This power is being translated not merely into the wielding of an "environmental influence" but also into some participation in the exercise of the leadership function. The purpose of this chapter is to indicate broadly the main ways in which government activity, particularly positive regulatory action, impinges on what we have called the leadership function in the large corporation and to note briefly the main changes in this direction which have occurred in the recent past.

GOVERNMENT AND PRIVATE BUSINESS LEADERSHIP

Government, as a source of influence upon those immediately in charge of corporate affairs, stands on a footing in many ways different from that of the other interest segments that we have mentioned. The potential power of government is superior to that of all the other groups. The latter, along with the firm and its management, are "the governed."

Government consists of the members of the executive and legislative branches, judges, and officials of an array of administrative agencies, together with powers granted to them by a body of written or unwritten laws, rules, and regulations.[1] In a democracy, at least, government supposedly exists to serve the ends of the people, not of the state. In practice, this means in good part serving the interests of those groups who can make their will and desires felt by the officials charged with the formulation, interpretation, and enforcement of laws.

[1] "Government" has been variously defined, the emphasis sometimes being on the officials making up "the government," sometimes on the body of laws and rules which together "form a framework of action for the individual." The statement in the text is not intended as a precise definition.

Government, then, does not constitute an independent interest segment but is a means through which the groups in the community seek to maintain and further their respective interests.[2] We shall not attempt, however, to trace the causes or aims of regulation by the state. It is enough for our purpose to consider government as a source of influence on the business firm (hence, in our terminology, an interest group), recognizing that it may serve numerous masters and that its influence on business leadership may reflect in varying degrees the interests of such groups as at the moment possess political power.

Another difficulty in discussing government as a source of influence impinging on business leadership derives from the complexity of the agencies and delegated powers through which the formulation and administration of public policies are achieved. We must disentangle, further, the nature and effects of statutes, court decisions, executive rulings, and particularly the activities and determinations of administrative agencies. It is also necessary to distinguish between statements of policy, on the one hand, and the administration of these policies, on the other.

The difficulties in analyzing the effect of governmental controls on the exercise of business leadership suggest certain analogies, occasionally noted by others, between the conditions under which business policies and public policies are formulated and administered. In both the large corporation and government under democracy, there is delegation of authority from an electorate to a legislature (which in the corporation may be taken to be the board of directors). In both, we encounter difficulties in making the franchise effective. Disfranchisement has gone further in the corporation than it has in a democracy such as the United States. In both the corporation and the political field, executives and administrators have taken over part of the legislative function. Here,

[2] The members of a community can be classified in a number of ways. The grouping used in Chap. 7 is significant for a study of business leadership, but it is not necessarily a useful or comprehensive classification for a study of group pressures operating upon government.

again, the tendency is much more marked in the large corporation, in which the board of directors has yielded a large part of its function of formulating policies to the executive group. In both government and the large corporation, a range of pressures—emanating from affected interest groups—conditions the decision-making of those who formulate and administer policies. With respect to internal organization, problems of diffused responsibility, delegated powers, and bureaucratic administration (in the invidious sense of the phrase) are encountered in both government and big business. In both, many "policies" evolve without deliberate planning out of the acts and decisions of "administrators." And in both, the character and background of the "administrators" are important independent variables operating within the not inconsiderable range of discretion permitted by formal grants of power and the pressures of affected interest groups.[8]

With so much by way of background, we may now ask: What is the relation between government activity in the economic sphere and the exercise of business leadership as we have defined the latter phrase? More specifically, in what ways and to what extent does the former affect the exercise of business leadership by the individuals and private groups with whom we have thus far been concerned?

In attempting to answer these questions, we need to distinguish among the different types of government intervention in economic affairs, all of which do not affect the decision-making of private business leaders in the same way. Some regulation is intended merely to facilitate and implement the exercise of private business leadership. Other controls restrict the freedom of the private business leader but do not to any large extent substitute decision-making by public officials for that of private business leaders. Finally, some sorts of intervention take the form of substituting decisions by government

[8] There has been considerable discussion in recent years of the increasing power and growing range of activities of the executive branch of the federal government and of administrative agencies. The latter in particular have come to be, in their respective spheres of jurisdiction, policy-makers as well as policy administrators.

officials for those of private business leaders, the extreme case being the complete assumption of the leadership function by government, as occurs in the case of public ownership.

GOVERNMENT REGULATION AS A CONDITIONING FACTOR IN PRIVATE BUSINESS LEADERSHIP

Not a little government activity in the economic sphere consists of helping private business firms to carry on their operations. Government helps to create and maintain institutions which set the rules for the conduct of business. These institutions are considered necessary to the carrying on of business and are taken for granted by the private business leader. Such, for example, are the laws of property and contract and the machinery created for their enforcement, the body of corporation law, bankruptcy and reorganization procedure, laws pertaining to fair weights and measures, and so on. While these rules and regulations facilitate business dealings, they also have a restrictive influence on private enterprise. The right to carry on business involves the obligation not to violate the rights of others. But some forms of governmental implementing activity do not have even the slight restrictive effects noted above. They represent entirely positive aids offered by government to the carrying on of private business operations. Such, for example, are the dissemination of information by government and the creation of standards.[4]

Through such implementing or facilitating activity, government sets up rules of conduct or "patterns of action" for private business leaders. While certainly not considered an interference with the exercise of business leadership by private individuals, the kinds of government action noted above may frequently have significant effects on the decisions made by business leaders and may even help to determine who will participate in the exercise of business leadership. For example, the development of bankruptcy and reorganization procedure may have a vital bearing on such decisions as whether liquida-

[4] For further consideration of the "implementing" type of government activity, see Leverett S. Lyon, Myron Watkins, and Victor Abramson, *Government and Economic Life*, Vol. 1, pp. 33-34 and Chaps. 4-9.

tion of an ailing company should occur or what terms those in charge of a corporate reorganization will offer the creditors and stockholders of the firm. Even more obvious are the possible effects of patent laws on price policy and on decisions as to undertaking new investment or introducing new products. The liberalization of corporation laws, by weakening the position of the stockholder, has helped to determine who can participate in the exercise of the leadership function in the large corporation. These illustrations could be multiplied.

Another type of government intervention also serves to shape the environment within which the business leader operates and thus to condition his decision-making. We may call this "economic management," wherein government seeks to operate directly on certain economic variables, the control of which is beyond the scope of private business leadership. Government management of the monetary system is an excellent example. The authorities responsible for monetary policy do not attempt to interfere directly with the individual business firm[5] but rather to control such variables as the supply of money and the rate of interest. In contrast with the implementing type of government activity which we have been discussing, however, monetary control does involve more or less continuous decision-making on the part of government bodies.

Thus government monetary policy may lead to important changes in the level and structure of prices, the volume of employment, and the rate of industrial production. Public intervention of this sort—which would include also the government's efforts in the fiscal sphere, much of its control of international trade and the foreign exchanges,[6] and some types of agricultural policy—does not involve the direct exercise of a veto power by government over the decisions of business leaders. Although occasionally restrictive in nature, its chief

[5] Certain monetary regulations do involve restrictions on the freedom of banks.

[6] Control of foreign trade may involve regulation directly restricting the freedom of private business leaders. See pp. 230-31.

effect is to change some of the underlying economic conditions which private decision-makers consider as given data in choosing among alternative lines of action open to them.

GOVERNMENT REGULATION AS A RESTRICTIVE FORCE

We come now to regulation which directly restricts the freedom of action of private business leaders. This is the type of government intervention in economic affairs upon which public attention has been focused in recent decades. Here we have to deal with rules and prescriptions directly limiting what the individual business leader may do and even providing for the substitution of decision-making by government for that of private individuals. We shall concern ourselves at first with the kind of regulation which circumscribes the freedom of private business leaders but which does not, except incidentally, involve taking over by government of any considerable part of the leadership function. In the section following we shall discuss intervention which leads to active government participation in decision-making in particular industries and firms.

The greater part of so-called government regulation of business involves the exercise of a continuing restrictive influence rather than continuous participation in private decision-making. For the most part, this type of control arises out of the passage of laws regulating or prohibiting, directly or indirectly, certain types of entrepreneurial activity. The passage of the law creates the restrictive influence. The influence continues through the threat of enforcement. But within the limits defined by the statute, as interpreted by the courts and other enforcing agencies, businessmen continue to make the decisions which are the essence of the leadership function. No continuing supervisory relationship is created between particular firms and any governmental body; and private decision-makers are not required, within the range of discretion permitted by law and administrative rulings, to seek the approval by public officials of decisions currently being made. Though no public agency exercises a continuous approval func-

tion, private business leaders take into account in making their decisions the limitations imposed by statute and judicial and administrative rulings. In this fashion, the regulation becomes a part of the environment conditioning the exercise of business leadership. It restricts the range of alternatives open to the business leader, but within this range the latter continues to operate without government interference.

Numerous federal enactments in the last fifty years, especially in the last decade, have been of the type here under discussion. Federal antitrust legislation and regulation of unfair trade practices,[7] the National Labor Relations Act, the Fair Labor Standards (Wages and Hours) Act, and the securities acts of 1933 and 1934 have been primarily of this type. Each of these acts, together with the relevant judicial and administrative rulings, has defined or prohibited certain patterns of action. But none of the regulations being described has established a continuing relationship between individual firms and a government agency in such manner that the agency takes over from private individuals approval of some or all of the decisions affected by the regulation.[8]

In some measure, however, positive acts of business leadership by public agencies may result from this type of regulation. Such leadership may involve either initiation or approval of decisions. When the Fair Labor Standards Act was passed in 1938, Congress, by prescribing a minimum wage level in the statute, in effect changed the wage scale prevailing in certain industries paying less than the minimum wage. This was a positive and significant act of leadership imposed on the firms in these industries. For firms paying more than the

[7] Including, for example, the Sherman, Clayton, Federal Trade Commission, Robinson-Patman, Miller-Tydings, and Wheeler-Lea Acts.

[8] Under the securities acts of 1933 and 1934, the SEC stands in a continuous supervisory relationship to the firms subject to its jurisdiction, but primarily only for the purpose of enforcing adequate disclosure of certain types of information, particularly as to the terms of new security issues. Though such regulation, unlike that of the other agencies mentioned, implies a continuous supervisory relationship, it does not imply SEC participation in the making of decisions on matters concerning which disclosure is required by law.

minimum, the law created a new influence, setting a floor below which businessmen could not go in their wage negotiations. Within these limits, businessmen continued to make wage decisions without the interference of any public agency.[9]

More often, in this type of regulation, government participation in leadership arises not out of the passage of legislation but out of acts of enforcement after the legislation is passed. Setting of wage minima by industry committees above the minimum specified by the Fair Labor Standards Act constituted acts of leadership, in which the committees initiated, and the Wages and Hours Administrator approved, the decision made. The Sherman Act for fifty years has been an important influence conditioning the exercise of leadership by private individuals. The influence becomes active leadership when proceedings to enforce the Act are successfully concluded. The chief decision-makers in these cases are the courts and, especially in the case of consent decrees, the Antitrust Division of the Department of Justice. Similarly, the existence of the Wagner Act and the rulings of the National Labor Relations Board and of the courts condition the manner in which businessmen may deal with their employees, while individual acts of enforcement may lead the Board to assume momentarily the role of business leader in this or that firm.[10] The same is true of the work of the Federal Trade Commission.

In general, it is characteristic of the type of regulation here under discussion that it is applied to wide sectors of the economy rather than to individual industries or firms.[11] For these sectors, new patterns of action to which business leaders must conform are created.

The line of distinction between this type of regulation and

[9] In times of war, government decision-making in the field of wage determination is, of course, much more extensive.

[10] The powers and regulatory activities of the War Labor Board have significantly impinged upon private business leadership, but we confine ourselves to peacetime regulation.

[11] See, for example, J. M. Landis, *The Administrative Process* (1938), pp. 16-17.

what we have called implementation is by no means always clear. Both determine patterns of action for the businessman and to that degree create "influences" which limit his freedom of action. One type, however, is intended primarily to implement and facilitate the exercise of private leadership. The other is intended not merely as a facilitating device but as a method of forcing private leadership to conform to certain aims of public policy. The former becomes absorbed into the mores of the business community and creates legal and economic "institutions." The latter also becomes a part of the business leader's conditioning environment, but he is more aware of the extent to which such regulation limits his freedom of action.[12]

There are similarities and overlapping between what we have called "economic management"—positive acts of economic leadership applied directly to such fundamental variables as, for example, the supply of money—and the type of regulatory action with which we are now dealing. The direct economic management involved in controlling, say, the volume of the nation's imports or the supply of money may also necessitate regulation directly restricting the freedom of individual business leaders. Many measures aimed at controlling fluctuations in the balance of payments or the volume of foreign trade (exchange stabilization funds, tariffs, and so on) represent examples of the broader type of economic management without involving much if any direct restriction of the activities of particular concerns; but measures such as import and export licenses, which serve somewhat similar purposes,

[12] Conceivably, at some time in the future, recent regulatory enactments might also become absorbed in the mores of the business community and might be considered a necessary means of facilitating business leadership. For this to happen, however, the immediate aims and social perspective of private business leadership will have to undergo a transformation, greater for some types of regulation than for others. Government guarantee of the right to bargain collectively might eventually come to be viewed as a necessary implementing activity without too drastic a change in the outlook of businessmen. If the business community should ever place primary emphasis on the criteria of "public welfare" and "national interest," the type of regulation we have been discussing might be generally accepted by business leaders as a necessary means of aiding private leadership.

involve a highly restrictive type of regulation impinging directly on the decision-making of businessmen.[18] Government price policies involve economic management but may also represent, as in direct price control, highly restrictive regulation.

The second similarity between restrictive regulation and broad economic management arises out of the fact that both have an impact upon important economic variables and effect changes in the direction of private economic activity. In the case of restrictive regulation, government itself does not make the individual decisions which alter the working of the economic system, but its regulation does force or influence businessmen to make these decisions. For example, lower prices or higher wages may be brought about indirectly through government regulation of competitive practices and collective bargaining. Thus restrictive regulation is also a means of exercising economic leadership by government, and the results for the functioning of the economy may be fully as important as those resulting from positive acts of leadership applied directly to such factors as the supply of money or the level of interest rates, for example. The chief difference is that the restrictive regulation directly limits the business leader's freedom of action in making decisions on matters which are considered to be within the field of his concern, while economic management involves decision-making by government in matters which do not come within the scope of decision-making by private business leaders.

ACTIVE LEADERSHIP BY GOVERNMENT

While private industry has been profoundly affected by the types of governmental activity thus far considered, government has not in these cases directly taken over from private decision-makers the exercise of substantial elements of the leadership function in particular firms or industries. In the type of regulation now to be discussed, public agencies have intervened directly in decision-making. Government officials,

[18] Indeed, the latter type of control may involve, through government approval or veto of individual transactions, assumption by government of part of the leadership function.

largely through administrative agencies, stand beside or above corporate managements in some fields and continuously weigh certain types of management decisions in the light of their own independent judgments and of the policy criteria laid down by legislative enactment.[14] Public officials have become part of the entrepreneurial group, more or less continuously engaged in decision-making in the firms subject to this type of regulation.

The fields in which government regulation has most often taken the form of participation in the leadership function are the public utilities—transportation, electricity and gas, and communications.[15] Both state and federal agencies have participated in leadership, but we shall concern ourselves with only the federal agencies.[16]

The important federal agencies which have come to exercise some part of the decision-making function (in the large nonfinancial corporations with which this book is concerned) are chiefly the Interstate Commerce Commission, the Securities and Exchange Commission (in its regulation of public utility holding companies), the Federal Power Commission, and the Federal Communications Commission.[17] It is with the work of these commissions that we shall be primarily concerned. Other federal agencies also exercise varying degrees of leadership, but chiefly in fields occupied in the main by firms smaller than those in which we are interested, for example, the Maritime Commission, the Civil Aeronautics Board, the Bituminous Coal Division of the Department of the Interior, and

[14] Of course, the extent to which such agencies can exercise independent judgment is circumscribed not only by law but also by judicial review.

[15] Air, motor, water, and pipe-line transportation, as well as the railroad industry, are subject to this type of regulation. In the fields of banking and insurance, government regulation involves some active participation in leadership, but financial corporations are beyond the scope of this study.

[16] For an early discussion of participation by public utility commissions in company management, see Charles S. Morgan, *Regulation and the Management of Public Utilities* (1923). This book deals primarily with state and local rather than federal regulation.

[17] For short summaries in a single convenient source of the powers and activities of these agencies, see Lyon, Abramson, and Associates, *Government and Economic Life*, Vol. 2, pp. 648-60, 763-848.

some agricultural agencies.[18] We are considering only the situation which existed before 1940. From that time on, the American government came increasingly to manage the entire economic system as the country girded itself for war and was finally plunged into the world conflict.

In the fateful times during which this book is being written, reference to war and the preparation for war is inevitable. Government participation in decision-making grows tremendously when war occurs or threatens. Private business leaders

[18] Although consideration of agriculture, with its myriad of small units and special problems, has no place in a book devoted to the large corporation, developments in federal agricultural policy during the last decade invite analysis in terms of the concepts and categories being discussed in the present chapter. Today, the federal agencies concerned with the "agricultural problem," practically all of them centering in the Department of Agriculture, run through nearly the entire gamut of types of governmental activity discussed in this chapter. Educational and much other established routine work of the Department and of the state extension services and experiment stations can be said to implement private enterprise in agriculture. This is an example of the first type of government activity mentioned on p. 225. In the AAA programs taken as a whole, the federal government is engaged in broad economic management seeking to manipulate economic variables beyond the control of the farmer—that is, production and prices of specific commodities—in somewhat the same way that it seeks to influence the volume of imports or the level of interest rates through its commercial and monetary policies. Control of the volume of production and the level of prices of particular agricultural commodities, variables which (like the volume of foreign trade) move in the first instance in response to decisions of private entrepreneurs, implies that government must either itself make the price and production decisions or else influence private entrepreneurs to make the decisions which will lead to the desired results. Benefit payments and penalties for exceeding production or marketing quotas are means of exercising such an influence and to that extent represent "restrictive regulation." Loan provisions clearly involve direct economic management, altering demand conditions faced by individual farmers. In general, recent federal agricultural policy represents economic management in broad sectors of agriculture and also restrictive regulation, though if penalties and incentives are large enough, the difference between these means of achieving the desired results and outright substitution of government for private decision-making is not so very great. In many respects, it is proper to say that for some purposes the federal government does exercise active leadership, not, however, in the individual farm but in entire sectors of agriculture taken as the units of control. For some discussion of this range of problems, see Edwin G. Nourse, Joseph S. Davis, and John D. Black, *Three Years of the Agricultural Adjustment Administration* (1937), especially Chap. 12. For a summary of developments in federal agricultural policy, see Lyon, Abramson, and Associates, *Government and Economic Life*, Vol. 2, Chap. 23.

take orders from government officials as to prices, volume and types of production, hiring and payment of labor, creation of new facilities, and so on. The economic system becomes one giant productive organization, with many aspects of the leadership function centralized in government offices. This subject, however, cannot be pursued here. We shall confine ourselves to consideration of government participation in leadership as it is normally evidenced in peacetime.

For a limited period, between 1933 and 1935, government participation in active leadership went far beyond the public utility fields and included practically all of industry. Through the National Recovery Administration and the NRA code authorities, government officials participated with industrial leaders in initiating and approving a variety of entrepreneurial decisions. The NRA episode involved both the restrictive type of regulation, as in the control of trade practices, and governmental participation in leadership, as in setting minimum wages and prices and in the control of output and investment. Leadership was exercised largely with the industry rather than the firm as the unit of control, but administration of the code provisions involved entrepreneurial control by the code authorities over the activities of those responsible for decision-making in individual firms. As significant as was the role of government in the NRA experiment, equally or even more important was the extent of collective decision-making by private business leaders, with the industry rather than the firm as the unit of control.[19]

The distinguishing characteristics of the type of regulation now under discussion, so far as the normal exercise of business leadership by private individuals is concerned, should be made clear. Regulation of this type, particularly as it has evolved in the public utility field, provides for administrative agencies which to varying degrees participate with management in the exercise of the leadership function in the regulated industries. The leadership is partial; it consists chiefly in exercising an

[19] For a detailed analysis of the NRA experience, see Leverett S. Lyon and others, *The National Recovery Administration* (1935).

approval rather than an initiating function; and it is ordinarily confined to decisions on only certain types of problems, not to the entire range of matters concerning which business decisions must be made. But on the types of problems being regulated—for example, rate-making or the issuance of new securities—management decisions are subject to governmental supervision and must be submitted to a public agency for approval, in the light of policies which the agency has formulated. Sometimes the regulation may entail initiation, as well as veto or approval, by the regulating body.

These regulatory agencies are primarily concerned with rate-making: the setting of prices in the fields of their jurisdiction. Management must file contemplated price changes with the commission, which may veto or suspend as well as approve the proposed changes; and ordinarily the commission itself may impose changes upon the entire industry or upon individual firms. To an increasing degree, however, the powers of these commissions have been extended to other than rate-making problems. Thus management may have to submit to the commission for approval decisions regarding new security issues, expansion, abandonment of facilities, mergers and the acquisition of the assets or securities of other companies, the terms of reorganization or liquidation, and other matters. Not all the agencies mentioned have the power of veto over all these decisions, and the agencies vary among themselves in the extent to which the powers granted to them are used.[20]

The powers of the regulatory commissions arise out of enabling statutes, which define the actions over which regulatory power is given to the agency and establish certain broad criteria to be used in the exercise of this power. These criteria —such as protection of the public interest, prevention of discriminatory or unreasonable charges, the maintenance of a sound transportation system, or the provision of adequate

[20] In general, more attention is paid to rate-making than to problems of finance and organization, although generally management must seek the agency's approval in these latter matters, also.

facilities—leave wide room for the use of independent discretion by administrative officials in exercising their veto powers and in themselves initiating changes.[21]

Possession of power and the exercise of leadership are not the same thing. We have had occasion to emphasize this distinction in earlier chapters dealing with minority and financial groups. This distinction is important, also, in considering the control activities of regulatory commissions. While the ICC has had the power to control the terms of new security issues of railroads since 1920, the Commission has not exercised its powers in this connection as vigorously, especially during the 1920's, as it has its control of the level and structure of rates.[22] The same has been true of state public utility commissions. On the other hand, the SEC has apparently used its power to control the issuance of new securities, in the case of public utility holding companies, more aggressively.[23] The extent of active leadership by a regulatory agency cannot be fully ascertained merely from a perusal of the provisions of the enabling statute, or even of its published rules and regulations. One must go behind these to what the commission really does.

REGULATION AND LEADERSHIP BY THE INTERSTATE COMMERCE COMMISSION

It is no part of the purpose of this study to analyze in detail the relations between government and large-scale indus-

[21] See, for example, I. L. Sharfman, *The Interstate Commerce Commission*, Pt. 2, pp. 349 ff.

[22] It is not to be implied, however, that the Commission completely neglected the financial field. As early as 1893, the Commission had stated the need for regulation of security issues and for a good many years before 1920 had recommended that it be given this power. (See the Commission's *Interstate Commerce Commission Activities 1887-1937*, pp. 163-64.) Once acquired, the powers were used, but not as vigorously as in the case of rate-making.

[23] It is interesting to contrast the handling of the problem of banking influence by the two agencies. In the few years that have passed since 1935, the SEC has already promulgated successively the arm's-length bargaining and competitive-bidding rules. (See p. 218.) On the other hand, the ICC did not, at least until 1944, seriously disturb railroad-banker relationships, except, perhaps, in reorganizations in the last few years. It is true that the ICC has for some time required competitive bidding for equipment obligations, but this requirement was not extended to other types of railroad securities until this chapter was going to press, in May 1944.

try, even in the fields in which regulation has meant substitution of decision-making by government for that by private individuals. Before concluding this discussion, however, it might be well to give concreteness to the generalizations of the several preceding pages by indicating the extent to which government regulation has been translated into active leadership in the best known and oldest of the federal regulatory commissions, the Interstate Commerce Commission.

Although the original Act to Regulate Commerce was passed in 1887, effective regulation by the ICC dates from the adoption of the Hepburn Act of 1906, and in its more comprehensive scope from the passage of the Transportation Act of 1920. In 1931, a leading authority was able to write of the ICC's regulation in the railroad field as follows:

> . . . The magnitude of the railroad industry alone is indicative of the substantial slice of our industrial apparatus which is removed from the incidence of *laissez faire* doctrine. But the unusual character of this interference is evidenced primarily by the comprehensive scope of the administrative powers to which the carriers, and particularly the railroads, are subject. The entire cycle of their organization, financing, charges, and practices, is embraced within the ambit of the Commission's authority. The Commission's original function of preventing unreasonable and discriminatory rates has been rendered a positive and highly effective instrument for the regulation of charges and the control of returns. Under its present rate-making authority, the Commission may suspend changes in rates before they are put into effect; it may prescribe minimum as well as maximum rates for the future; it may establish joint rates and regulate their division or apportionment in the public interest; it is charged with the responsibility of prescribing such rates as will support railroad credit and maintain an adequate transportation system. . . . It is authorized to regulate safety of operation, service practices and the utilization of facilities, extensions and abandonments of line, the issuance of securities and assumption of obligations, interlocking directorates and pooling arrangements, acquisitions of control and actual consolidations; and it is empowered to prescribe and police carrier accounts, to require regular and special reports, and to enforce publicity of all carrier operations. While there is continuing lip worship of the doctrine that interference with management is both undesirable and invalid, the freedom of the carriers is so circumscribed in all significant directions that true

managerial independence, as distinct from freedom in the affairs of internal organization and administration, is largely a matter of the past in the railroad industry. Moreover, not only does each individual carrier find practically all of its major policies and practices effectively conditioned by the legal environment resulting from the vast grants of authority conferred upon the Commission in the public interest, but from many angles the carriers as a whole, despite multiple corporate ownership and control, are conceived as a national transportation system and are made to serve general transportation needs, without regard to individual interests. The prevailing charter of administrative control involves large affirmative responsibilities as well as extensive powers of restriction. In regulating service, particularly in periods of emergency and congestion, in formulating a comprehensive consolidation plan, in fixing general rate levels, in adjusting rate divisions, . . . the Commission is acting virtually as a superdirectorate for the entire railway net.[24]

The Commission has been concerned most significantly with the question of rate-making, and in this sphere it is the final decision-making authority for the entire industry. All rates and rate structures are subject to its control, and the carriers' proposals for alterations in both individual rates and the general level of charges have not infrequently been refused or seriously modified.[25] (In the ordinary course of events, however, proposals for routine changes in individual rates, although subject to the Commission's power to suspend, are not disturbed by the ICC.) The Commission itself, on its own initiative or on the complaint of shippers and other carriers, has imposed rate changes upon the roads. Initiation by the

[24] Sharfman, *The Interstate Commerce Commission* (Commonwealth Fund), Pt. 1, pp. 3-5; see also the same, pp. 283-85, and Lyon, Abramson, and Associates, *Government and Economic Life*, Vol. 2, pp. 764-65.

[25] See Sharfman, *The Interstate Commerce Commission*, Pt. 3-B, especially pp. 3-4, 6; Lyon, Abramson, and Associates, *Government and Economic Life*, Vol. 2, pp. 809-10, 821-25. An interesting example of the Commission's use of its powers to control the general level of rates occurred in the application of the roads for a flat 15 per cent rate increase in 1931. The Commission denied the application but did permit certain smaller specific increases. See *Fifteen Per Cent Case*, 178 ICC 539; *46th Annual Report of the Interstate Commerce Commission*, 1932, p. 8; Sharfman, *The Interstate Commerce Commission*, Pt. 3-B, pp. 161 ff.

Commission is not common, however, and has been generally limited to a relatively few comprehensive rate cases. In rate-making in the railroad industry, the individual company is no longer the only unit of control.[26] Proposals for changes by the roads are worked out collectively by the various companies and apply automatically to all affected carriers.[27] The Commission's rate orders may similarly apply to all roads in a territory or in the entire country, although many, if not most, rate cases before the Commission involve specific roads.

Despite the Commission's protests that its activities are not to be considered a substitute for private management, it does play a highly important role in price-making in the railroad field. Of course a great deal of rate-making is still in the hands of the companies; the Commission's chief function is that of review, not initiation; and the Commission cannot, nor does it attempt to, flout existing rate relationships, which exert an extremely important influence on rate decisions by both the roads and the Commission. Nonetheless, the Commission's powers in this field are very great; it may and sometimes does overrule management proposals; it exercises its (veto) power of review with criteria of price policy in mind that do not necessarily jibe with the profit criteria of the roads; and the Commission's judgment as to the effects of rate changes may be substituted for that of the managements.[28] It is true, however, that the roads are still relied upon to initiate most rate changes and that, in the approval of minor changes in specific rates, the Commission may rely largely on

[26] This condition is of long standing and, to some extent, antedates the ICC—as in the early use by the railroads of pools, boards of arbitration, and so on to keep their rates in line.

[27] Changes in rate schedules and classifications ordinarily originate in inter-road committees of traffic executives representing the various roads in particular territories. On occasion, as in the *Fifteen Per Cent Case*, all roads in the country jointly present proposals for changes. On the other hand, as noted later in the text, the majority of rate changes probably involve individual roads.

[28] See Lyon, Abramson, and Associates, *Government and Economic Life*, Vol. 2, pp. 821-25; also *52nd Annual Report of the ICC*, 1938, pp. 5-7.

the judgment of the executives of the railroads concerned.[29]

The Commission's powers of control over management in the fields of finance and organization are also extensive, although the degree of its leadership in these spheres has not been as marked as in rate-making. The Commission has exercised a veto function with respect to extensions and abandonments, substituting criteria of public convenience and necessity for that of profitability. Its control of the issuance of securities, though occasionally resulting in denial or modification of applications, has not led to such active participation in the exercise of the leadership function as have its rate-making powers.[30] In financial matters subject to its jurisdiction—for example, new issues, acquisitions, assumption of obligations, and consolidations—the Commission seldom initiates. Its leadership function has been one of (frequently routine) approval.[31] During the 1920's the Commission's approval of many important financial acts was either of a routine sort or else represented belated acceptance of *faits accomplis*.[32]

[29] Sharfman, *The Interstate Commerce Commission*, Pt. 3-B, especially pp. 417, 463-64, and Pt. 4, p. 352.

[30] See Sharfman, *The Interstate Commerce Commission*, Pt. 3-A, pp. 506, 528, 555, 622; Kent T. Healy, *The Economics of Transportation in America* (The Ronald Press Company, 1940), pp. 532-35. Control of new security issues of the smaller, less stable roads has been more active than in the case of the larger companies. As for the latter, "The Commission has for the most part followed the judgment of the railroads as to the set-up of their financial structures. About all the control has amounted to for the larger railroad companies has been to insure that the money went into the treasury for legitimate purposes. In no sense did the Commission attempt to say whether the proposed use of the money, raised by an issue, was desirable or even sound, and rarely did it pass upon the financial advisability of the type or amount of the various securities issued." (The same, p. 533.) However, in May 1944, the Commission did impose the condition of competitive bidding on the sale of railroad securities, although with certain exceptions. *New York Times*, May 11, 1944.

[31] See Sharfman, *The Interstate Commerce Commission*, Pt. 3-A, pp. 20 ff., 92, 502-03; Pt. 4, pp. 249-50; Healy, *The Economics of Transportation in America*, pp. 541-42.

[32] Note, for example, the acquisitions by many roads in the 1920's. For examples of various types of financial manipulation which took place despite ICC scrutiny, see *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. 25, 76 Cong. 1 and 3 sess.; and also the same, S. Rept. 1182. It is only fair to note that the Commission was handicapped during the twenties by a lack of certain powers (for example, over holding companies) which were subsequently granted to it.

It is customary for students of government regulation to speak of the powers of regulatory commissions over financial affairs as constituting "an encroachment upon management" beyond that represented by control of the rate-making process. It is difficult, however, to think of a more fundamental encroachment on entrepreneurial freedom than price-fixing by government, which after all is what is involved in control of the rate-making process. In fact, the ICC's regulation of financial affairs has, in the past, imposed far fewer restrictions on the freedom of management than has its control over rates.

As we indicated in Chapter IX, the Commission's control of reorganization proceedings, once extremely weak, has been strengthened substantially since 1933. It has also been given the power to approve carrier application for loans from the RFC. Its powers have been extended to cover railroad holding companies, and it may forbid a road to vote stock owned in another carrier.[33] In these and other ways—primarily, however, with respect to approval rather than initiation—the Commission participates with railway executives in the leadership function.

As we have pointed out, the Commission's leadership in rate-making is applied not only to specific firms but also to groups of companies and, on occasion, even to the entire industry as the unit of control. In rate-making, the single company is no longer the only unit of control, even in changes initiated by the carriers themselves. The same widening of the boundaries of the unit to which entrepreneurial control is applied has occurred in other phases of the Commission's activities. To the extent that leadership is exercised over substantial parts or all of the railroad industry, such control becomes one of the most important parts of the environment restricting the activities of the managements of particular roads; and management's freedom is further restricted by the fact that the Commission's leadership in many matters is ap-

[33] See *46th Annual Report of the ICC*, 1932, pp. 12-15; *47th Annual Report of the ICC*, 1933, pp. 17, 19-20; Sharfman, *The Interstate Commerce Commission*, Pt. 3-A, pp. 495-98.

plied directly to the firms concerned. Thus the Commission's leadership encompasses simultaneously the entire industry and the companies taken separately.

The Commission's role as business leader in the railroad field has been summarized succinctly (and, in the opinion of some, too strongly) in the following manner. "In short, the managerial supervision by governmental authority has in large measure replaced the initiative of private management in the formulation and execution of business policies affecting the quantity, quality, and price of railroad transportation service."[34] The result is that "in the railroad field any clear-cut differentiation between the sphere of private management and that of public control is largely obliterated."[35]

It need scarcely be added that the powers and activities of the ICC are not necessarily matched by those of all other federal agencies whose regulation involves in some degree the exercise of business leadership. The extent of regulatory control by the ICC, however, indicates extremely well the variety of ways in which decision-making by government can be substituted in some part for the leadership of corporation managements.

GOVERNMENT OWNERSHIP

One type of relation between government and business remains to be discussed. Where complete government owner-

[34] Lyon, Abramson, and Associates, *Government and Economic Life*, Vol. 2, pp. 764-65; see the same, pp. 859-60.

[35] Sharfman, *The Interstate Commerce Commission*, Pt. 1, pp. 284-85. The following statement by the ICC does not refute this conclusion: "There is gross exaggeration in the idea that every act of the railroads is subject to regulation. The railroads have a large degree of initiative in the making of their rates, and have freely made a multitude of reductions to meet competition. We have no power to control their passenger service, and exercise very little control over their freight service. They select and pay their officers without supervision or hindrance. Nor do we undertake to tell them what equipment and supplies they may buy, how they shall operate their shops or maintain their tracks, what rails, ballast, and ties they shall use, what stations or other buildings they shall erect, what construction contracts they shall let, or how they shall manage their affairs in many other ways. The pattern of their regulation is in no way unique, but is substantially the same as is now applied generally throughout the country by the States or the Federal Government to other public utility companies." *52d Annual Report of the Interstate Commerce Commission*, 1938, pp. 7-8.

ship exists, all aspects of the function of business leadership are taken over by public officials. The unit of control is a combination of economic resources under government rather than private ownership. Entrepreneurial decisions are made by government officials—subject, however, to the pressures of interest groups in much the same way as the activities of private business leaders are affected by these influences. The chief difference, for the exercise of business leadership, arises out of the formal substitution of some concept of the public welfare as the ultimate criterion of policy for that of private gain.

Two examples of government ownership may be mentioned, not because they are necessarily typical but because they illustrate how, through ownership in key sectors of the economy, government can exert a strong influence on business leadership in areas remaining under private ownership. The first example is the Tennessee Valley Authority, which is itself engaged, in competition with private companies, in the production and distribution of electric power. The implications of the complete exercise of the entrepreneurial function by a public agency in this case extend beyond the boundaries of the TVA itself. Through the TVA, government exerts a strong influence on the managements of the private utility companies. The federal government thus stands in a two-fold relation to the managements of the private companies. First, government as such exerts pressure directly through regulatory agencies—in the case of the federal government, through the SEC and Federal Power Commission. Secondly, government, as a competitor, exerts pressure indirectly. Of these two types of pressure, it has been suggested, the managements of the private utilities fear the latter more.[36]

More interesting in its implications in many ways is the Reconstruction Finance Corporation. Here government ownership and operation (in peacetime) have occurred not in industry but in the field of banking. Certain aspects of the federal government's increasingly important role as banker, particularly in its effects on the private banking business, were

[36] See Landis, *The Administrative Process*, p. 121.

discussed in Chapter IX. The ramifications of the lending activities of the government, however, extend far beyond the banking field.

Through the RFC, the federal government had during the thirties become a banker to many companies, particularly the railroads. We have already commented at length on the power that goes with control of the supply of money-capital, especially in the case of ailing firms needing new injections of the "life-blood of industry." In this respect, government is no exception. In supplying funds to industry, the government lending agency is in a position to exact terms—as to financial policy, management compensation, terms of reorganization. The power thus acquired may or may not be used. In the railroad field it has been used on occasion, and here and elsewhere the government as banker has been able to induce compliance with its wishes through the bludgeon of financial power.

Thus the RFC in its capacity as banker adds another weapon to the federal government's armory. In the railroad field, for example, government pressure can now be exerted in two ways: directly, through the ICC, and, indirectly, through RFC lending.

Once the United States began to prepare for war in 1940, the federal government's lending and investing increased tremendously in scope. Government funds poured into a vast array of industrial plants engaged in war production, and the RFC, through subsidiary corporations, became the creditor of many enterprises and the owner of numerous plants being operated under private management. In wartime, the government's direct control over industrial operations is far-reaching and needs no support from its financing of private industry. But when the war is over, even after wartime controls are relaxed, tremendous power will remain in government hands as a result of its having been wartime banker to industry. Whatever use is made of this power by government, the repercussions of the government's wartime banking activities

will leave their impress on private industry for many years to come.[37]

There is little reason to believe that present tendencies in the direction of stronger influence by government on private leadership will be reversed, although they may be modified. Thus far, however, despite the examples of government ownership and the extensive participation by government in decision-making in the public utility fields, government regulation in peacetime has taken chiefly the forms of a restrictive influence and of broad management of the economic system as a whole. Participation in decision-making within individual firms or for particular industries is still not the general rule. With present tendencies toward greater government participation in economic life in all spheres of government regulation, we may expect that restrictive regulation will continue to narrow the range of alternatives open to private management and that participation by government in business decision-making will continue to expand. The development of these tendencies in the past has depended on a number of factors, the most important of which has been the result of the never-ending struggle among private interest groups, including management itself, to control the formulation of public policy. The nature and direction of these tendencies in the future will continue to depend upon the result of this struggle.

[37] In addition to financing war plant expansion, the federal government has accumulated large stockpiles of raw materials and has become the sole buyer of many imported commodities essential to the war program. Its activities in this direction have not only revolutionized international trade and financial practices during the war; its accumulations of materials, its financing of foreign developments, and the changes it has created in established trade channels will have repercussions on domestic and international markets for many years after the war is over.

CHAPTER XI

THE INFLUENCE OF THE OTHER INTEREST GROUPS

Thus far, we have had little to say about a number of groups which may exert an important influence on the exercise of business leadership in the large firm. Of those listed on page 148, the ones not discussed in previous chapters are competitors, suppliers of goods, customers, labor, and those providing specialized services (lawyers, engineers, and accountants, for the most part).

All of these groups contribute to the environment of conditioning influences which restrict the freedom of the active business leaders. While some of them participate on occasion in decision-making, they do not regularly and to any considerable extent take part in the exercise of the leadership function in a given concern. More concretely, representatives of these groups do not as a regular thing meet with officers and directors to make the entrepreneurial decisions which govern the firm's activities. But they do exert varying degrees of influence on those who are concerned with making these decisions.

THE ROLE OF COMPETITORS

Of the interest groups now to be considered, competing firms exert the greatest influence on business leadership. The pressure involved here is "competition." The nature of competitive forces and their effect upon prices and other economic variables have long occupied the attention of economists. For the most part, however, the latter have looked upon competition as a set of impersonal market forces, acting mechanically to produce more or less preordained results.

With our conception of the business leader operating in an environment of influences emanating from diverse interest groups, competition becomes a set of pressures to be analyzed and traced to the firms and other business leaders whose

actual or potential behavior creates the competition. This is particularly the case when firms are large, or, more generally, when any market is confined to a relatively few sellers. Then various types of competitive pressure can be traced to specific firms and groups; measures taken by one concern are observed and countered by the others; and the results of this interplay of pressures is not entirely predictable. Not only do these competitive forces affect the decisions made by individual businessmen, but the latter's behavior also tends to react upon the nature of the pressures at work. This is true of the relations between buyers and sellers as well as of those between firms selling the same or similar products.[1]

The results which ensue from this sort of competition (and from the attempts to avoid or restrain it) depend upon the character of the businessmen, the relations of their firms to other firms and interest groups, and other factors which are equally difficult to include within the measurable and impersonal "market forces" with which the economist ordinarily deals. While the influences or pressures being considered here are in good part "market forces," they are not impersonal or immutable, nor do they yield mathematically predictable results. Hence inclusion of competitors (and buyers and sellers) as interest groups, and a study of their influence on decision-makers against the background of pressures exerted by the other interest groups, should prove of value in an analysis of the manner in which business leadership functions. The crude tools of the political scientist, as well as the more precise tools of the economist, need to be utilized.[2]

Obviously, the mere existence of competitors selling the

[1] See the discussion of the influence of buyers and sellers, pp. 253-55, below.

[2] The greater the number of sellers in a market, and the smaller each is, the less important becomes this sort of approach to the nature of competition. In markets in which sellers are numerous and small, competition can be considered as a set of more or less mechanical forces to which the individual firm automatically reacts without its being able to do much if anything to alter the pressures operating upon it. Also, in this case, competition appears as the mass effect of the behavior of many largely anonymous concerns.

same or like products creates an influence which seriously conditions the exercise of leadership by a firm's decision-makers. The businessman cannot set his prices without considering the present and potential behavior of his competitors. He is limited by similar considerations, also, in the decisions he makes as to volume of output, quality of product, and degree of advertising and selling activity. Competition helps to determine not merely what he should charge for his products but also what he must pay for materials and services.[8]

Where firms are few and large, competition in the broadest sense brings to bear upon decision-makers in a concern a wide range of powerful pressures, a great many of them directly traceable to the plans and acts of the leaders in other firms in the same and related industries. Large firms seek to maintain and in some cases to enlarge their position in the market. In so doing, the leaders of each firm resort not only to price changes but also to various types of "non-price competition"—changes in quality and appearance of products sold, changes in volume and type of advertising, and other sales promotion techniques. These competitive techniques are utilized by the leaders of a firm as parts of a broad strategy against other firms in the same and similar industries. The measures adopted by any one concern are affected by and in turn directly influence the tactics being followed by competing concerns. Competitive strategy of this sort involves not only price and non-price competition on the selling side but also maneuvers to ensure sources of supply of raw materials (compare the struggle for ore reserves at an earlier period in the steel industry), strategic use of the power inherent in patent

[8] See, for example, the analysis of factors determining wage policies in International Harvester, in TNEC, *Industrial Wage Rates, Labor Costs, and Price Policies*, Monograph No. 5, pp. 103-07, especially p. 105. An interesting and somewhat unusual example of the effect of competition on wage negotiations occurred in 1941. At the time that United States Steel was negotiating with the SWOC with respect to a wage increase, National Steel announced a voluntary increase to its own employees of ten cents an hour, which was probably more than the SWOC expected to gain from United States Steel. Since National's employees were unorganized, the union could not accept less from United States Steel, nor was the latter in a position to insist on a smaller increase. See *New York Times*, Apr. 8, 15, and 22, 1941.

rights, struggles to control new technological developments, and a wide range of other techniques.

Pressure from competitors is not felt by all firms to the same degree. Similarity of products sold, number of firms in the market, and the relative size of the firms are some of the factors which help to determine the extent to which the price, output, and marketing decisions of individual decision-makers are conditioned by what other firms are doing or may do. But these are only some of the factors. The decision-makers themselves are independent variables. Two identical sets of market conditions may lead to different results, depending on how those in control react. And of course business leaders strive constantly to alter competitive relationships in their favor to ease the pressure from competing firms. Trade association activities, intercorporate ownership and interlocking directorates, mergers, and advertising of brand names are merely a few of the ways of doing so.

Where competitors continue to be independent—independent in the sense that no formal or tacit agreements as to common policy exist—competition remains merely as an "influence" restricting the freedom of individual businessmen. The influence arises out of what competitors actually do—the prices they charge, the kind of product they sell—and, particularly where the number of sellers of a given range of products is relatively small, out of the fear as to what competitors *might* do.[4]

The leadership role of the competitor, however, frequently goes beyond exerting an influence. Influence easily shades into participation in the exercise of some part of the leadership function, especially with respect to the determination of prices.

[4] "Fewness of sellers" creates the situation to which economists have applied the term "oligopoly." Strictly speaking, "fewness" in the sense intended by the economist exists whenever the number of firms is small enough so that any one takes into account what his competitors may do in response to action which he initiates. "Fewness" in this sense is entirely a matter of degree. Even in an industry with a hundred firms or more, individual concerns pay attention to the present and potential behavior of their competitors—if not all, at least some of them. Of course, they pay even more attention if their competitors number only two or three.

Through the old-fashioned pool (now largely obsolete as well as illegal), the cartel, trade associations, the old NRA codes for a short period, and, more generally, through informal conferences and tacit agreements, the members of an industry may collectively make important decisions regarding prices, the volume of output, the allocation of markets, and so on. When competitors get together in this fashion, decision-making on an industry basis results. Out of the influence or pressure of competition comes active leadership exercised by the competitors collectively. Needless to add, not all of such collusive leadership is illegal.

The line of distinction between the reciprocal influence of competitors on each other and collective decision-making is not a very clear one. When firms are few and large, and when the wages of the "sin of price cutting" become too much for the businessman to contemplate, uniform prices may result without the aid of clandestine meetings or even of the telephone. The price decisions, though identical, may be made individually by the various firms. The result, though not the method, is the same as if the price makers had actually met and formally decided on a common course of action.[5]

Common action reflecting a group will may be effectuated among firms which are not merely competing sellers. For example, the increasing strength of other groups (labor, particularly) has indicated to business leaders in various concerns and even in different industries the need and advisability (from their point of view) of banding together. To the extent that this occurs, the unit of entrepreneurial control tends to expand beyond the boundaries of the individual firm.[6] The existence of common bonds of interest may take many forms, for example, common ownership or banking connections, common business problems, common possession of pat-

[5] For a convenient survey of types of competitive restraints in American industry, see TNEC, *Competition and Monopoly in American Industry*, Monograph No. 21; also A. R. Burns, *The Decline of Competition* (1935).

[6] However, the enlarged unit of control holds only for the purpose toward which the common action is directed. For other purposes, the individual firm, or perhaps a different group of concerns, is the unit of control.

ents, and so on.[7] It should be emphasized that these factors merely facilitate but do not necessitate common action.[8]

When the reciprocal relations and influences among competitors become formalized and put on a more permanent basis through trade associations, cartels, and similar organizations, the decisions and acts emanating from such groups may affect the exercise of leadership within individual firms in several ways. These formalized group activities may (1) merely implement the exercise of leadership by individuals (aid member firms through issuance of statistical and other information and similar trade-association activities), (2) influence and restrict individual leadership (by exerting informal pressure to curtail output, not to sell below cost, and so forth), or (3) lead to the substitution of group decision-making for individual leadership (as when prices or the allocation of output or the attitude to be taken toward labor's demands are decided by the leaders of the industry and imposed upon all members of the group).[9]

In addition to helping or influencing member firms in the manner indicated in the preceding paragraph, industry associations frequently seek to exercise pressure on government to further the interests of the industries which they represent. The political activities of some of these groups have been important factors affecting public opinion, legislation, and the shaping of policy by the regulatory agencies.[10]

[7] On the influence of patents, see TNEC Monograph No. 21, pp. 73-78, 84-85, 104-05, 158-65; TNEC, *Patents and Free Enterprise*, Monograph No. 31 (1941), especially Chaps. 5-7.

[8] For further (but overdone) discussion of these bonds of interest, see Robert A. Brady, *Business as a System of Power* (1943), pp. 227 ff. See also TNEC Monograph No. 21, pp. 189 ff.; National Resources Committee, *The Structure of the American Economy*, Pt. 1, pp. 158-65.

[9] The literature on trade association activities is voluminous. Among more recent additions to this literature, see S. N. Whitney, *Trade Associations and Industrial Control* (1934); TNEC, *Trade Association Survey*, Monograph No. 18 (1941); Monograph No. 21, pp. 225-67; Burns, *The Decline of Competition*, Chap. 2; E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress*, Chap. 10; Benjamin S. Kirsh, *Trade Associations in Law and Business* (1938).

[10] This aspect of the work of trade associations and other similar business groupings is emphasized by Professor Brady. See Brady, *Business as a*

Such institutionalized inter-company relationships may spread beyond the boundaries of individual industries, as in the Chamber of Commerce of the United States, the National Association of Manufacturers, and similar "super-industry" organizations. As far as the effect upon member firms is concerned, influence and what we have in Chapter X called "implementation" (see p. 1225) may come out of such groups; but, at least in this country, there is little evidence of much business leadership originating in these associations and being imposed upon the decision-makers in individual firms or industries.[11] One should not belittle the influence of such organizations, however. Business leaders, though belonging to different industries, can develop a strong feeling of economic and group consciousness,[12] and it is not difficult, especially if a strong and active leadership exists, for a group will to emerge from these inter-industry relations. With the cohesion given by such common interests and aims, the economic resources in back of super-associations of corporation executives make them capable of exerting great influence upon both public opinion and the direction of government policy.

System of Power; also TNEC, *Economic Power and Political Pressures,* Monograph No. 26.

[11] Despite his emphasis upon the power and influence of such super-industry or "peak" associations, Brady states that "trade associations and their Spitzenverbände [super-industry groups] are largely, if not in many cases exclusively, political-pressure bodies." (*Business as a System of Power,* Columbia University Press, p. 312.) This is probably an overstatement so far as American trade associations are concerned, although, of course, the political and propagandist character of much trade association activity cannot be denied. As far as the super-industry groups are concerned, the statement quoted seems clearly to hold. Brady's book (especially Part 3) contains a provocative discussion of the role of super-industry groups and of their relations to the growth of big business and intra-industry co-operation.

[12] Corporation executives, particularly the more prominent ones, and wealthy individuals generally decry the fact that the "New Deal" has fostered a feeling of class-consciousness among workers and low-income groups. Class-consciousness, however, is not new in this country, and it is most pronounced among those groups who decry it while not recognizing the phenomenon among themselves. Common social backgrounds, common business interests, and common fears, prejudices, and loyalties create among those who possess wealth and economic power a strong and clear-cut feeling of membership in an economic and social class.

SUPPLIERS AND CUSTOMERS

The influence of suppliers of goods and of customers deserves more consideration than can be given here. They are two more of the groups whose economic interests lead them frequently to seek to exert pressure on those responsible for decision-making.

The nature of the customers' group differs among types of firms and industries. Large firms producing finished consumers' goods are not ordinarily subject to serious *direct* pressure from this group—either from middlemen or the ultimate consumers.[13] Obviously, even unorganized consumers exert a strong influence, which is measured by the nature of their demand curves for a given product. Their tastes and incomes are among the most fundamental data which the producer must take into account in making his decisions. This type of influence, however, clearly belongs in the category of impersonal market forces. If consumers are small, numerous, and unorganized, their pressure is not exerted directly, or deliberately as part of the bargaining process. Beyond this, customers must be few or highly organized to influence directly the decisions of the selling firms.[14] For this reason, the makers of capital goods, raw materials, and semi-finished products—items bought by industrial users—are more likely to be subject to direct pressure from customers than makers of finished consumers' goods.[15] The pressure is likely to be

[13] This is not true, however, where mass outlets are relied upon for an important part of the distribution of the product. Compare, for example, the pressure which Sears Roebuck was able to exert at one time on Goodyear Tire and Rubber as the most important buyer of the latter's products. Other tire manufacturers also were subject to important influences from mail-order houses, the automobile manufacturers, and the oil companies, all of which provided mass-outlets for the distribution of tires. (See Walton Hamilton, and others, *Price and Price Policies* (1938), Sec. 3; TNEC Monograph No. 21, pp. 49-50.)

[14] To the extent that the "consumers' movement" expands and gains in unity and power, it will be possible for the great body of buyers of consumers' goods to exert greater pressure upon large-scale producers and sellers, either directly or through influencing legislation.

[15] We should include raw materials for consumers' goods as well as for industrial goods. Markets characterized by many sellers and few buyers are frequently found in agriculture, for example, in tobacco, livestock, and

greatest if a firm's product is taken primarily by a single customer or a few customers acting in concert.[16]

The large corporations with which we are concerned have tremendous power as both buyers and sellers. If one of them is faced by one or a few strong buyers, the resulting tug of war may go in favor of either party, depending on a number of factors. Obviously, the relations existing between a given firm and its competitors are an important factor in determining the outcome of maneuvers between the firm and important customers. Pressure exerted from the side, so to speak—from competitors—adds to that exerted from the front, by customers.[17]

The large corporation is also subject to direct pressures from sellers, which may be as strong as, and in some cases stronger, than those coming from buyers.[18] Here again the situation varies among markets and industries. Where sellers are few and large or are otherwise able to act in concert, even the large corporation which buys from them may be subject to considerable pressure. Where the power of sellers is enhanced by patent rights and other means of reinforcing monopolistic control of supply, even the large corporate purchaser may be at a serious disadvantage in negotiations. The results of the pressures from sellers take the form of higher prices and contracts otherwise unfavorable to the buyer and, on occasion, the influencing of policies of the

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milk. See Burns, *The Decline of Competition*, pp. 156-65, 169; and TNEC Monograph No. 21, pp. 120-21, 182-89, 208-14.

[16] The reciprocal purchasing arrangements existing between the railroads and the producers of steel rails represent an example of mutually reacting pressures on two sets of large firms which sell to each other. (See Burns, *The Decline of Competition*, pp. 171-73.) Considerable customer pressure on the steel companies also has come from the automobile manufacturers.

[17] In the consumers' goods industries, the body of unorganized small-scale customers is protected far more by the interacting pressures among competing sellers than by any positive direct action which they can take.

[18] Exception should perhaps be made for firms—such as Swift, Armour, General Foods, National Dairy Products, and the large tobacco companies—whose chief purchases are made in agricultural markets in which the individual seller is economically very weak. However, agricultural products are to a significant degree being sold by co-operative groups, and, more important, agricultural interests are particularly effective in securing the help of government to strengthen their bargaining position.

buyer in which the sellers may be interested—for example, the buyer's selling policies and his relations with his own competitors.

Of course, even if the sellers do not have these sources of power at their disposal, there will still be strong pressure on the buying corporation to direct its purchases to one firm rather than another. This type of influence takes a number of forms—from price concessions, through all the sales promotion techniques that human ingenuity has devised, to more subtle arrangements such as interlocking directorates, intercorporate ownership, and so on.

THE LABOR GROUP

The strength of the pressure exerted by labor on decision-making in the large corporation has increased greatly in recent years, particularly in the last decade. Of all the interest groups mentioned in Chapter VII, labor had for decades the greatest stake and the least voice in large-scale industry.[19] That situation has now changed significantly as the labor group has achieved the power that comes from organization and the support of government.

Today, in many lines of industry, and even in the largest corporations, labor exerts an extremely strong pressure on management in the range of business decisions affecting wages, hours, and the conditions of employment. Through the collective bargaining machinery, labor participates to some extent in making the decisions which determine wages, hours, and working conditions. Final veto rests with management, but a strong union, protected by rights granted by legislation,

[19] Perhaps exception should be made for the group of ultimate consumers, of which the labor group makes up the greater part. The importance of labor's stake is measured chiefly by (a) the fact that much the larger part of the national income takes the form of wages and salaries and (b) the fact that the risks which are borne by labor (primarily the risk of unemployment) are heavier than those borne by the other groups. It is freely granted that we cannot precisely evaluate in any objective fashion the risks borne by labor or any other group. In terms of human happiness and the impact on individual lives, however, it does not take a peculiar set of value judgments for one to conclude that the risk run by labor, merely from the possibility of unemployment, is much greater than that borne by the stockholder, small or large.

frequently possesses sufficient power to force management to accept its terms. In any event, the collective strength of a strong union imposes a pressure on management that seriously circumscribes the latter's freedom of action in wage and employment issues, and administration of a collective bargaining contract brings union and management officials together for joint determination of numerous decisions at the operating level.

It is not our purpose to discuss how far labor's powers gained through collective bargaining and the written contract represent an "encroachment upon management;" nor is there any point in trying to define precisely the boundary beyond which labor's participation in collective bargaining moves over from the exercise of an "influence" or pressure to an actual participation in the exercise of the decision-making function. It may merely be said that the collective bargaining process does permit a strong union to some extent to share decision-making with management on a number of issues directly affecting the workers' welfare.

Labor's influence has been confined very largely to issues in which the worker is directly and immediately concerned—wages, hours, and the conditions of employment generally. On the whole, labor has displayed little desire to participate actively and generally in other phases of management.[20] And the idea of such worker participation has been anathema to management itself, which still strongly resists the idea of granting labor some share of responsibility in the general management of the business. There have been examples of labor-management co-operation in meeting production problems, particularly since the First World War,[21] but such examples of labor participation in even routine decision-making have thus far been the exception rather than the rule. Recently, the idea of labor-management co-operation has been pushed vigorously by some labor leaders, particularly in the

[20] See, for example, Sumner H. Slichter, *Union Policies and Industrial Management* (1941), pp. 561-64.

[21] See the same, Chaps. 17-18.

CIO;[22] and there is reason to believe that, as labor-management relations become stabilized after the war, the extent of such co-operation will increase.[23]

Some of labor's participation in decision-making affects the very top levels of management. Important issues regarding wage scales or recognition of a union are likely to bring labor leaders together with the highest officials of a company, and the process may be repeated when contracts have to be renewed. In some companies, union leaders may be called in frequently by one or more top officials when important labor issues are being decided. A large part of labor's sharing in decision-making, however, involves only the lower levels of management—in the shop and factory rather than the executive offices. While decisions made at this level may significantly affect a firm's costs and volume of production, they are concerned essentially with day-to-day matters which come within the purview of the foreman or superintendent rather than the higher levels of management.[24]

On the whole, labor is more likely to be able to participate continuously in decision-making on labor matters at the lower

[22] See, for example, M. L. Cooke and Philip Murray, *Organized Labor and Production* (1940), Chap. 17; C. S. Golden and H. J. Ruttenberg, *The Dynamics of Industrial Democracy* (1942), Chaps. 8-9.

[23] See Slichter, *Union Policies and Industrial Management*, pp. 564 ff. Labor-management co-operation during the present war may accelerate this tendency in the postwar period. For some discussion of labor-management co-operation on wartime production problems, see Clinton S. Golden, "Collective Bargaining and Accelerated Production," and Wendell Lund, "Problems of Labor Productivity in Wartime," *The Annals*, Vol. 224 (November 1942), pp. 96-103 and 110-16.

[24] Even at these lower levels, labor participation in decision-making has been vigorously opposed by many executives, although labor's role in such cases is in large part confined to offering suggestions and advice and does not entail the assumption of any final veto power by labor. The following statement by two advocates of labor-management co-operation is of interest in this connection. "In other words, someone has to 'run the business,' to use a common American expression. As between unions and management, there is never any doubt as to where this responsibility should and actually does lie. Though labor organizations do not desire, and cannot be permitted if they should desire, to run the employer's business, it is equally a mistake to assume that an employer has no need for aid from his employees in matters of management." Cooke and Murray, *Organized Labor and Production* (Harper and Brothers), p. 85.

than at the higher levels of management. Frequently, when labor questions are referred to top-management for decision, the labor group's role shifts from taking part in decision-making to exerting pressure on the executives who will make the final decision.

In fields other than wages and hours, working conditions, and production management in the narrow sense, labor has had practically no voice. Financial, marketing, public relations, and similar types of policy—as well as over-all planning and co-ordination—have not been the object of much attention from even strong labor groups. In this respect, American labor is essentially conservative. It is content to leave general management in the hands of officers and directors, and to protect and further its own interests by concentrating on those measures more directly and obviously affecting labor income and the conditions of work.

Labor's impact upon business leadership is to be measured not merely by its direct influence on management but also by the power it wields as a political pressure group. Until very recently, labor found the pressure it was able to exert directly on management inadequate to achieve its ends. It therefore sought to increase its power in industry indirectly by influencing the course of government regulation. In this effort, of course, it has had a very large measure of success. The power which the labor group now has in industry arises in large part out of the use to which labor first put its power as a pressure group in the political sphere.

THE INFLUENCE OF PROFESSIONAL GROUPS

In concluding these brief references to the interest groups not considered in detail in earlier chapters, mention must be made of one which continues to exert a subtle but nonetheless significant influence on business leaders. This group is made up of those supplying specialized technical services to the firm—lawyers, engineers, and accountants, for the most part.[25]

[25] Bankers, particularly investment bankers, supply services of this sort, also, but their role has been considered at length in the chapter on financial groups.

Of these professional groups (excluding bankers), lawyers are the most important in their influence upon business leaders, but the influence of accountants and engineers is also significant.[26]

The way in which business leadership is affected by these specialists differs from that which results from the relations of a firm to the other interest groups thus far considered. In discussing the influence of bankers, government, competitors, or customers, for example, we could speak of the "pressures" exerted by these groups as they sought to benefit from the decisions made by business leaders. The influence of a professional group, however, does not arise primarily out of deliberate pressure used to further its pecuniary or other interests, although this factor is frequently important.[27] The

[26] Except for specialists such as market analysts and the like, economists as a professional group have had surprisingly little influence on businessmen. Many large firms have "economists" on their staffs, but the independent influence they exert *as economists* is likely to be slight. They may play a significant role in their capacities as technical experts in particular business fields—marketing, finance, perhaps statistics, and so forth—but "general" economists hired or consulted by business leaders are more likely to reflect the opinions of the business world than the reverse. However, the work of many specialized "business economists" has played a significant role in fostering research in marketing and similar problems, fields in which the rule of thumb persisted long after the industrial laboratory was common and even after "scientific management" had found its way into the factory. See, for example, National Resources Planning Board, *Research—A National Resource*, Pt. 3, *Business Research.*

[27] It is present more in the case of lawyers than in that of other professional groups. The scramble for remunerative connections, particularly in the case of reorganizations, by the more prominent firms specializing in corporation law is enough to make one wonder whether the "professional" attributes of the work of these firms are not open to as much question as the work of bankers, who also on occasion claim for themselves the status of professional practitioners. In this connection, note the following: "Corporate reorganization has long been regarded as one of the most lucrative fields of legal endeavor. . . . In the aggregate, counsel fees frequently constitute the largest single item on the list of reorganization fees. The capacities in which attorneys may serve are numerous. . . . It is not to be wondered, therefore, that these, among the richest stakes in reorganization, are eagerly sought and that the various legal positions are among the most valuable items of reorganization patronage.

"But there are stakes in addition to direct compensation. Counsel for the company may be desirous of continuing as counsel for the new, or reorganized, company. The value of their professional reputations at times gives them an interest in protecting the management against the assertion of claims based

influence arises—we may almost say spontaneously—out of the professional advice and services which businessmen seek from these groups. It operates not only by shaping particular decisions of the businessman but also by coloring his outlook with respect to various types of problems. We have here, then, not a deliberate pressure but a subtle type of influence akin to indoctrination. Thus, the undeniable influence of the legal profession on business leadership arises chiefly out of the nature of the law itself and out of the infusion into the businessman's approach to his problems of legal procedures and the lawyer's viewpoint.

The influence of the legal profession on business leadership manifests itself primarily in three ways: (1) the role of lawyers in modifying the institutional (chiefly legal) framework within which business operates, (2) the absorption of a legalistic approach into business through the extensive use of legal counsel, and (3) the presence of lawyers as officers and directors of large firms.

The role of the lawyer in modifying the legal framework within which business operates is both obvious and important.

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on fraud or mismanagement, for often the acts or omissions upon which such claims will be asserted had in the past received their express approval, or at least their countenance. The same observations are apt with respect to counsel for the bankers. . . .

"The size of the lawyers' bill must frequently be astounding to security holders and others. This cannot be taken to mean that their compensation is always excessive. The importance of the role of lawyers in reorganization is difficult to overemphasize. . . . Nevertheless the vice of the situation remains despite persuasive arguments that particular jobs are well done. . . . Part of this unseemly tendency of the financial bar to demand huge fees may be due to the business cast of law practice of that kind. Part may be due to over-specialization in financial centers with large law offices composed of dozens of lawyers, a huge overhead, and consequent artificial standards of the worth of legal services. In other words, organization for the practice of law on the large scale of mass production has contributed to the alleged necessity of computing legal fees on an overhead rather than on a service basis. Part may be due to the fact that the practice of financial law has been to a great extent monopolized by relatively few firms. This has meant setting monopolistic prices on the legal services of the select financial bar. But whatever may have been the cause, the end result has been that more conservative and modest professional standards have been discarded." SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Pt. 1, pp. 866-68.

An outstanding example was the introduction of the holding company device into the New Jersey incorporation statute at the end of the 1880's.[28] This event ushered in the period of the modern holding company—with all the consequences for the exercise of business leadership which have followed from the use of this corporate device. While legal clarification of the status of the holding company may have been inevitable, the timing and form taken by this development owed much to the legal profession, particularly to one lawyer, James B. Dill.[29]

At about the same time, lawyers had adopted the device of the trust to the exigencies of the consolidation movement and thus facilitated the expansionist activities of such men as Rockefeller. The legal profession, working through the courts and legislators, has helped to frame the rules for corporate reorganization and liquidation.[30] The creation of the corporation itself as a legal fiction has made the exercise of business leadership on the modern scale possible—at the same time that it has enabled individual business leaders to avoid personal responsibility for some of the consequences of their leadership. Businessmen act within and are conditioned by a framework of law created by lawyers in their various capacities, as private practitioners, judges, and legislators.

Within this framework, the business leader leans heavily on the counsel of lawyers. His firm stands in a multitude of contractual relationships to the many parties with which it does business. He must tread his way through the maze of laws and administrative rulings which seek to define his obligations and responsibilities, and he is forced to rely ever

[28] See J. C. Bonbright and G. C. Means, *The Holding Company*, p. 57.

[29] See the article on Dill in *Dictionary of American Biography*.

[30] For extended analysis of the law and procedures in reorganization, see SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees* (8 parts), of which Pt. 8 deals with the law pertaining to equity and bankruptcy reorganizations. A summary of the importance of the role of lawyers in carrying through reorganizations is given in Pt. 2, pp. 519 ff. In this connection, see W. O. Douglas, *Democracy and Finance* (1940), Chap. 19.

more heavily on the written word and the formal document as personal contacts and informal understandings become increasingly impossible. Knowing that in a business world so implemented by legally defined relationships, the ultimate arbiter of business disputes and conflicts is the black-robed judge (himself a lawyer and approachable only in the language of the law), the business leader must of necessity lean heavily on "the advice of counsel," before, during, and after his acts of leadership. Naturally, lawyers do nothing to discourage this reliance on their profession.

The lawyer, in acting as guide, is concerned with the question of legality in the formal sense. His advice emphasizes the extent to which contemplated action does or does not conform to formal standards set up by statute and judicial decision. The advisability of particular transactions is likely to be judged on the basis of whether or not they can be translated into a convincing brief for his client. His concern with economic or social and sometimes even business consequences is secondary. Hence, the tendency of executives and directors to rely upon the advice of counsel and of lawyers serving on the board in matters that have a business, economic, or social aspect means that they are likely to get advice which is legally impeccable but which may largely disregard the more important business and economic issues involved.[31]

[31] Compare the following by Chief Justice Stone: "There is little to suggest that the Bar has yet recognized that it must bear some burden of responsibility for these evils [arising out of various corporate malpractices]. But when we know and face the facts we shall have to acknowledge that such departures from the fiduciary principle do not usually occur without the active assistance of some member of our profession, and that their increasing recurrence would have been impossible but for the complaisance of a Bar, too absorbed in the workaday care of private interests to take account of these events of profound import or to sound the warning that the profession looks askance upon these, as things that 'are not done.'

"We must remember, nevertheless, that the very conditions which have caused specialization, which have drawn so heavily upon the technical proficiency of the Bar, have likewise placed it in a position where the possibilities of its influence are almost beyond calculation. The intricacies of business organization are built upon a legal framework which the current growth of administrative law is still further elaborating. Without the constant advice and guidance of lawyers business would come to an abrupt halt. And whatever standards of conduct in the performance of its function

The lawyer's role is a positive as well as negative one. He not only protects the businessman against the legal consequences of his acts but clears new channels through the law for activities of the businessman for which there is no explicit legal precedent—but for many of which precedents may be created through reasoning by analogy before a sympathetic judge. The framing of corporation charters, the elaboration of the trustee device, and the use of dummy subsidiaries are a few of a multitude of possible illustrations.

Perhaps nowhere is the lawyer's work more important than in reorganizations. Although crucial business and financial problems are involved, lawyers frequently decide whether reorganization is desirable. "They may choose the method of reorganization and select the forum and determine the strategy to be employed." In drafting plans of reorganization, they "determine mixed questions of law, banking, and business." Though the profession is inclined to deprecate the importance of its functions in reorganizations, numerous cases show "that the lawyer reigns supreme in reorganizations; in fact, it is not an over-statement to characterize him as the mainspring of the system."[32]

Lawyers, more than members of the other professional groups, are likely to serve on boards of directors and to become important officers of business firms. Not a few of the present chief executives of our largest corporations were originally lawyers, and came into their present positions either by promotion within the firm from the rank of general counsel or by being brought into the concern from law firms with

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the Bar consciously adopts must at once be reflected in the character of the world of business and finance. Given a measure of self-conscious and cohesive professional unity, the Bar may exert a power more beneficent and far-reaching than it or any other non-governmental group has wielded in the past." Harlan F. Stone, "The Public Influence of the Bar," *Harvard Law Review*, Vol. 48 (1934), pp. 9-10; quoted in SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Pt. 2, pp. 520-21.)

[32] The quotations in this paragraph are from SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Pt. 2, pp. 521-22.

which the company had dealings.[33] Numerous lawyers sit on the boards of large corporations. Some of them are officers heading the legal departments of the companies; some are on the board in their capacities as representatives of outside law firms serving as counsel; still others serve because their legal work makes them suitable as representatives of other interests, especially of estates and trusts representing large stockholdings. Whatever the original reason for their selection as directors, they bring to the board their legal training and point of view.

A chief executive with a legal background is likely to concern himself largely with matters of finance, organization, public relations, and relations with government. Responsibility for operations tends to be delegated. He is apt to be conservative in making price changes, and "order in the industry" is likely to be more appealing than aggressive price competition. The lawyer chief-executive may well be interested in the broader type of business strategy, and he is likely to be thoroughly at home in negotiations involving acquisitions, mergers, and reorganizations.

There is a select and narrow group of law firms, chiefly in New York, whose long and formidable names are known to some extent even in Main Street. Employment with these firms, at least until the attractions of government work acquired a new appeal after 1933, was the goal of the brighter graduates of the leading eastern law schools. These firms are closely linked with, and are really a part of, the financial community.[34] They serve the banks and larger corporations and not infrequently sit on the boards of the latter. They are particularly active in mergers and reorganizations; they do

[33] The list of recent or present presidents or board chairmen in large corporations whose careers began in the law is a long one. Included in such a list would be Taylor and Olds (as well as Gary in an earlier period) of United States Steel, Chester of General Foods, Babst and Abbott of American Sugar Refining, Kelley of Anaconda, Hardy of American Car and Foundry, Willkie of Commonwealth and Southern, McCarter of Public Service of New Jersey, Bledsoe of the Atchison, Topeka, and Santa Fe, and Scandrett of the Chicago, Milwaukee, St. Paul, and Pacific.

[34] See the latter part of the footnote on p. 260, above.

the legal work involved in the issuance of new securities; they represent various of the large firms in their dealings with government agencies. Their influence goes far beyond the giving of advice on legal matters. Their advice is sought in many cases on financial and other business problems; thev help to determine the terms of reorganization of weak firms; they have been known to assist in the choice of a new chief executive.[35] In these and other ways, the leading partners in these firms exert an influence of major importance upon the conduct of business leadership in our largest corporations.

The important role of the accounting profession is familiar to both economists and businessmen, although the extent of the accountant's influence on business thinking and business behavior is sometimes not fully appreciated. The accountant, for example, plays an important role in price determination, chiefly through the formulation of cost-accounting procedures. The great virtue of these procedures is not that they reveal what unit costs really are (in most cases an impossiblity by the very nature of the case) but that they provide plausible estimates which can be better used to justify prices charged than estimates based on less precise procedures. The emphasis placed by businessmen on covering total unit costs and the methods used by firms in computing these costs are indications of the accountant's influence. In valuation, depreciation accounting, dividend distribution, and other matters the accountant's influence reveals itself also. The effects on the decisions which businessmen reach are by no means inconsiderable.

Engineers also have exercised a strong and enduring influence on corporate management. The magnificent physical equipment which large-scale industry has at its command owes much of its recent development to the engineering

[35] One prominent New York law firm was very active in bringing to the attention of the bankers in charge of the Chicago, Milwaukee, and St. Paul reorganization of 1925-28 a candidate for the presidency of the reorganized company. This candidate was selected by the bankers. See Committee on Interstate Commerce, *Investigation of Railroads, Holding Companies, and Affiliated Companies*, S. Rept. 25, Pt. 21, 76 Cong. 3 sess., pp. 7-10.

profession. The engineer and the production management expert have also brought into the factory principles of scientific analysis and precise planning. "Scientific management" in some form has supplanted the rule of thumb in the shops and factories of large-scale industry, and the standards of research and planning applied first at the workbench have spread to the office and sales room. In addition, the leading engineering firms of the country have the ear of the top officials of large-scale business; they play an important role frequently in valuation cases, reorganizations, and the like; and they team with important legal and accounting firms in advising companies and their bankers in the issuance of new securities. The leading officials of such engineering firms can be found on the boards of directors of some prominent concerns, and an occasional one becomes an important executive in a company which he or his firm has been serving on a consulting basis.

Other professions, in addition to lawyers, engineers, and accountants, have left their impress on the thinking of business leaders and on the techniques which they utilize. We have already referred to market analysts and to technicians in the field of "business economics." Additional, though perhaps less important examples, could also be cited, but our purpose has been to indicate the source and general nature of this type of influence on the business leader, not to catalogue the entire list of professions with which he comes into contact.

INTEREST GROUPS AND BUSINESS LEADERSHIP

Obviously, it is impossible to evaluate or measure precisely the influence exerted by each of the interest groups that have been discussed. The pressures are not always easy to locate; they take numerous forms; and they differ widely among firms. Certain general tendencies over the last several decades, however, do stand out. The influence of stockholders and bankers has declined; that of government has greatly increased. Within the sphere in which it chooses to be interested, the influence of the labor group has greatly increased also.

It is clear that business leadership does not operate in an institutional vacuum. It is a far cry from the complexities of reality to assume that, in the large corporation, business leadership is a clearly defined indivisible function being exercised by a single individual or by a compact group. It is equally unreal to assume that business leadership is nothing more than a clearly defined channel through which the impersonal market forces of demand and supply work out their preordained results. Business leaders themselves are not automatons, and they operate in an arena in which economic and political forces are intermingled.

An analysis of the ways in which interest groups impinge upon the activities of business leaders, as well as a study of the internal organization created for the exercise of the leadership function, is necessary to understand how and why business leaders act as they do. The powers of some of these interest groups are weak, those of others, strong. These relative strengths and weaknesses vary with time and the changing institutional setting. As they vary, the environment within which the business leader operates and the stimuli to which he must react change also. The power of these groups is of great political as well as economic significance, for they exert pressures upon government as well as on business firms. Their importance, even in the economic sphere, goes beyond a mere study of business leadership. After all, the changing nature, strength, and activities of these interest groups represent the evolving framework of our economic system.

PART III

INCENTIVES AND THE PROFESSIONALIZATION OF BUSINESS LEADERSHIP

CHAPTER XII

FINANCIAL INCENTIVES TO BUSINESS LEADERSHIP: THE COMPENSATION OF EXECUTIVES

We have studied business leadership thus far primarily in terms of the organizational framework within which it has to operate in the large corporation. This framework determines who shall exercise the various parts of the leadership function and the nature of the major pressures reacting upon the decision-makers.

The manner in which business leadership is exercised, however, depends as much on the incentives at work as on the organizational setup. In particular, the extent to which the interests of individual groups, the welfare of the community as a whole, or the ends of public policy are furthered by business leaders depends in good part upon the incentives which the economic system provides.

The basic justification of a system of laissez faire was that the spur of profit to owner-managers of small enterprises operating in a perfectly competitive system supposedly ensured that private leadership, in seeking personal gain, would enhance the economic welfare of the community as a whole. Our economic system is far from being completely competitive, however, and the dominant type of enterprise is not the very small firm led by an owner-manager. As the organization for leadership has evolved into that which has been described in the earlier chapters, changes have taken place in the nature of the rewards available to business leaders. What are the incentives to which large-scale business leadership now reacts, and what effects do they have on the manner in which decisions are made in the large corporation?

THE NATURE OF INCENTIVES TO THE EXECUTIVE GROUP

The analysis of the earlier chapters points to the executive group as the one primarily responsible for leadership. We

shall therefore concern ourselves with the nature of the incentives, available to the leading executives in the large corporation, in which those responsible for active leadership are not the principal owners of the business. Where ownership, "ultimate control,"[1] and management are combined in the same group of persons, the incentives to business leadership are not substantially different from what they are in the private proprietorship. The interesting questions arise when substantial (though not necessarily complete) separation between ownership and leadership has taken place.[2]

The rewards available to the executive group are of two broad types: financial and non-financial. In the present chapter we shall be concerned only with financial incentives. The non-financial ones—which include such intangibles as the opportunities provided for satisfying the desires for prestige and power and the creative urge—are more in the domain of the psychologist than that of the economist; but a brief evaluation of their importance will be attempted in Chapter XIII.

The major financial incentives are of several kinds: (1) salary and bonus, (2) dividends and appreciation in principal from stock owned (and, to a minor extent, income from bonds), and (3) what, for lack of better term, we may call "gains of position." This third type takes many forms—for example, trading in the firm's securities on the basis of "inside information," directing the firm's purchases to a company in which an executive has a personal interest, and so on. This sort of inducement played an important role before the securities and public utility legislation of 1934-35, and these gains of position, though of lessened importance, undoubtedly exist in various guises today.[3] Not all such incentives are

[1] "Ultimate control" is defined on p. 188, above.

[2] The stockholdings of officers and principal stockholders were studied in Chap. 2. The value of and income contributed by management's stockholdings in the large corporation are investigated further in the next chapter.

[3] The provisions of the Securities Exchange Act of 1934 which, in effect, prohibit an insider from selling the stock of his company at a profit within six months of the time of purchase have had the effect of eliminating a

beyond the pale of the law, although most are frowned upon by public opinion. Unfortunately, statistical evidence on the prevalence of gains of this type is relatively scarce. Our chief information concerns the more extreme cases that are uncovered by government investigations or that are eventually brought before the courts or the SEC.[4] We shall therefore confine our analysis to the first two of the financial incentives mentioned: salary and bonus and the gains from stock ownership.[5]

TOTAL COMPENSATION OF LEADING EXECUTIVES

The two main types of compensation received by the corporation executive are the straight salary and the bonus. The former is a contractual payment of predetermined amount which is independent of short-period fluctuations in the company's earnings. The latter type of payment is not fixed in advance but is geared to the income of the firm.

The table on page 275 provides some of the basic material for a study of the total salary and bonus received by the

former fruitful source of additional income to many officers and directors. (See sec. 16 of the act.) Other anti-manipulative provisions in this act (for example in sec. 9), as well as compulsory reporting of management stockholdings to the SEC, have had a similar effect. For examples of the type of stock manipulation aimed at in the act, see the Senate report on *Stock Exchange Practices*. Report of the Committee on Banking and Currency, S. Rept. 1455, 73 Cong. 2 sess.

For summaries of actions recently taken by the SEC against company officials, see the releases and annual reports of the Commission. These cover, however, only the types of practices prohibited by the acts administered by the Commission. See also the Commission's special report on the famous McKesson and Robbins affair (*United States of America before the Securities and Exchange Commission in the Matter of McKesson & Robbins, Inc.: Report on Investigation*).

[4] For examples of such gains of position by corporate managements during the twenties and early thirties, see *Stock Exchange Practices*, Report of the Committee on Banking and Currency, S. Rept. 1455, 73 Cong. 2 sess., especially pp. 55-68; see also the numerous volumes of hearings before this committee bearing the same title. Perhaps the best known examples in recent years are those which occurred in McKesson and Robbins (see the report by the SEC cited in the preceding footnote) and in Associated Gas and Electric.

[5] Strictly, we should include also income from bonds and other fixed claims. However, these leading executives hold almost no bonds of their concerns, and consideration of management holdings of fixed income securities may therefore be safely omitted.

leading executives in a broad group of very large corporations.[6] The data refer to the year 1935. The companies studied are those of the 200 largest non-financial firms (in 1929) for which the pertinent data were available for 1935.[7] The leading executives chosen for study, in this group of 149 very large corporations, were the chairman of the board (if any), the president, and any other executives receiving compensation comparable to that of these two or known to have comparable responsibility and power. This method of selection leads to the inclusion of the most important one or two executives in each of the companies. In a few cases more than two officers are included.

The sample studied covers 264 executives in 149 companies, or somewhat less than two executives, on the average, per company. The data on compensation, applying to the year 1935, are based on reports filed with the SEC.[8] Salary and bonus have been lumped together.[9] At a later point, the

[6] The following several pages are based on part of an article, "Ownership and Compensation as Incentives to Corporation Executives," published by the author in the *Quarterly Journal of Economics*, Vol. 54 (1940), pp. 455 ff.

[7] A study of management ownership in the same group of companies was referred to in Chap. 2. (See p. 24, above.) In the analysis of management ownership, 155 companies were studied. In the present study of executive compensation, six additional companies were dropped because of the lack of necessary data.

[8] The executive compensation data were taken from the original reports filed with the Commission. I am deeply indebted to Dean John C. Baker of Harvard University, who made available to me his file of photostatic copies of these original reports for many of the men included in the present study. Reports on Form 10-K, for industrials and most public utilities, and on Form 12-K, for railroad and communications companies, were those containing the desired data.

Companies reporting on Form 10-K need list individually only the three highest salaries. In practically all cases this provided enough information. Form 10 (in most cases applying to 1934) listed salaries to all executives; and this was used as a check, in order to make sure that no executives who should have been included according to our criteria, but who did not receive one of the three highest salaries, were omitted. This led to the inclusion of additional men in two companies, and their salaries were estimated on the basis of the latest data available. In case of firms filing on Form 12-K, this problem did not arise.

[9] The salary and bonus data refer to dollar compensation; warrants or options to purchase stock, the value of which is indeterminate until they are exercised, are not included.

relative importance of each of these two types of compensation will be indicated.

One of the most striking facts revealed by the table on this page is the contrast between the total compensation of leading executives in the industrial companies and the compensation of the chief officers in the railroad and utility fields. The median salary and bonus of the industrial executives,

Distribution of 264 Executives According to Salary and Bonus Received, by Industrial Classes, 1935[a]

Total Salary and Bonus[b] (Unit: $1,000)	Number of Executives			
	Industrials	Public Utilities	Railroads	Total
0– 12.5........	3	1	5	9
12.5– 37.5........	14	12	19	45
37.5– 62.5........	38	25	24	87
62.5– 87.5........	35	9	3	47
87.5–112.5........	41	3	—	44
112.5–137.5........	11	—	—	11
137.5–162.5........	5	1	—	6
162.5–187.5........	5	—	—	5
187.5–212.5........	3	1	—	4
212.5–237.5........	1	—	—	1
237.5–262.5........	1	—	—	1
262.5–287.5........	—	—	—	0
287.5–312.5........	—	—	—	0
312.5–337.5........	2	—	—	2
337.5–362.5........	—	—	—	0
362.5–387.5........	2	—	—	2
Total executives....	161	52	51	264
Median[c] (Unit: $1,000)......	79.2	48.6	40.6	61.2

[a] This table appeared originally in an article by the author in the *Quarterly Journal of Economics*, Vol. 54 (1940), p. 464.
[b] Lower limit of class interval inclusive.
[c] Medians are based on the original arrays.

$79,200, was nearly twice that of the railroad officers and nearly two thirds more than that received by the leading executives of the public utility companies.[10] No railroad executive in our

[10] The contrast is less marked, although still pronounced, if these salaries are taken after deduction of income taxes. At present wartime tax rates, income taxes take a very large share of high salaries. For an interesting table showing the taxes payable on different salaries at the tax rates prevailing in 1929 and 1940 and approved by the House Ways and Means

sample of large companies received a salary of as much as $100,000 per year, and only a few utility officers fell in this select circle.[11] However, 71 out of 161 industrial executives, 44 per cent, received more than $87,500; and nearly 20 per cent received more than $112,500.

In the railroad field, the range of total compensation is fairly narrow. The compensation of nearly half of the railroad executives fell in the single class interval $37,500—$62,500. A similarly narrow range is found in the public utility field. Among executives in industrial companies, however, the dispersion in compensation is greater.[12]

Although the subject cannot be pursued here at any length, several suggestions may be offered to account for the variations in compensation revealed in the table on page 275.[13] Part, but only part, of the explanation lies in differences in ability. The more able executives can be expected to command higher salaries.[14] Further, even "top" executive ability is to

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Committee in 1942, see John C. Baker, "Limiting Executive Salaries in Wartime," *Harvard Business Review*, Vol. 21 (1942), p. 56.

[11] More recently, however, at least one railroad president has received a salary of $100,000 per year.

[12] The semi-interquartile ranges were, in thousands of dollars: rails, 15; utilities, 14; industrials, 27. However, the *relative* dispersion (measured by the interquartile coefficient) was slightly greater for the rails than for the industrials. That is, the dispersion in railroad compensation, though much smaller in dollars than that in industrial compensation, represents a slightly larger percentage of the typical or median compensation.

[13] It should be remembered that this table refers only to the one or two highest-paid executives in the companies covered. The relation between this highest bracket of compensation and the earnings of the other executives is indicated on p. 280.

[14] To some extent, also, the higher types of ability tend to flow toward those fields in which the opportunities for the exercise of able and aggressive leadership are greatest. The difficulties confronting the railroad industry, the relatively routine nature of the management problems among established operating utility companies, and the amount of government regulation in both fields would tend to limit the opportunities for aggressive leadership of the abler sort and to make it difficult for companies in these fields to justify the payment of high salaries. There is no way of proving that the general level of ability is consequently lower in these two fields, although a strong case can be made that the leadership evidenced at least in the railroad field suffers by comparison with that found among industrial corporations. (See *Fortune*, April 1938, pp. 156, 158.) Non-economic factors, particularly loyalty, tradition, and a desire for security, have kept some able men in the railroad industry at relatively low salaries,

some extent made up of specialized faculties—a flair for selling, a genius for organization or financial management, and so on.[15] The general market for executive ability thus tends to break down into submarkets, between which only a limited movement can take place to equalize rates of pay.

Perhaps more important is the fact that only in a restricted sense can a market for executive ability be said to exist at all. Buyers and sellers are not independent. The chief executive is in a sense his own employer. Within broad limits he frequently sets his own compensation. Even if the board of directors or a minority stockholding group is active and powerful, the chief executive's salary may continue to be considerably larger than that commanded by men of seemingly comparable ability in companies of similar size and profitability. In those cases in which the board or some other group is responsible for fixing the executive's compensation, the close relations likely to exist between the executive and the board or other groups militate against an outsider's underbidding a relatively highly paid executive. Important also is the fact that precise determination of a top executive's worth to his company is impossible. The activities of the chief executive affect all aspects of the company's operations, and the results of his good or bad management are inextricably interwoven with all the other factors which enhance or lower the firm's net income.[16]

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while the inbreeding and seniority practices, worship of tradition, and narrow vision generally found in the industry militate against the entry of leadership ability from outside the railroad field.

[15] Some leading executives to whom the writer has talked maintain that the chief executive must have a highly generalized sort of ability which can be used in any company and any industry. This does not seem to be wholly true. An individual with a particular combination of abilities may be very successful in one type of business and only moderately successful in another. Experience and training also tend to specialize leadership somewhat.

[16] Top management represents, in the economist's language, a relatively "indivisible" factor of production. We cannot continuously add in a particular company more and more managers or more and more hours of decision-making by one executive and thereby measure the difference in the effects on the company's profits of adding or taking away one small unit—as we can to some extent with a homogeneous labor force or with money capital. The economist's marginal analysis is thus inapplicable.

Nor can we ignore the fact that money compensation is only one of the incentives which attract the executive. Power, prestige, desire for security, an urge for creative work, and group loyalty are all motives. A large company can offer in the power and prestige that go with a position of authority a very important substitute for a high salary. If a man has been long associated with a particular firm, loyalty and a feeling of security may hold him in one company even if a higher income is available elsewhere.[17] These non-pecuniary motives will be discussed further in the next chapter. Taken alone, they are sufficient to account for substantial differences in the compensation of executives of approximately comparable ability.[18]

Other considerations thus far not mentioned also help to explain the differences in compensation among executives of similar ability. Differences in the size of companies undoubtedly constitute a factor. Another is the fact that an executive's compensation is not necessarily synchronized with the profits which result from his work. A chief executive approaching retirement may be receiving a salary which is primarily for work done in earlier years.[19] A young executive may be building for

[17] Policies of internal promotion from within the ranks accentuate this tendency. Such internal promotion shuts off the competition of executives in other companies who might be secured at lower salaries than a particular company is currently paying, while long association with and attachment to one firm may lead executives to remain with a company at lower salaries than they could receive elsewhere. Long association with a particular company also gives an executive a feeling of security which would be lost if he transferred his allegiance to another firm. The tendency of even "hired managers," especially chief executives, to identify themselves with their companies makes some men practically unavailable to other firms. A man who has spent most of his business life building up and "nursing" one concern may be unwilling even to consider a position elsewhere.

[18] An interesting recent illustration concerns Roy B. White, who resigned as president of Western Union Telegraph to succeed Daniel Willard as president of the Baltimore and Ohio Railroad. Mr. White accepted a reduction in salary in making the transfer. He had previously spent more than twenty years with the B. and O., and his attachment to the railroad field and to this company was apparently still strong. Further, he was succeeding a man whose prestige in the railroad and business world was very great. These factors were apparently adequate compensation for the decline in income. See *New York Times*, May 1, 1941.

[19] This is, for example, probably a partial explanation of the high salary

the future, but current low profits may force him to accept a small salary for the time being.

All of these considerations add up to the fact that, even in the "strictly business" atmosphere at the top of the management ladder, executive ability operates in an imperfect market in which personal and non-economic considerations play an important role in determining what an executive earns.

The compensation data cited on page 275 tell us almost nothing about the adequacy of this incentive as a spur to effective leadership. This much, however, is clear. Even after allowing for the heavy income taxes paid by leading executives, their compensation is considerably greater than that which would be available to them in any other vocation.[20] The only alternative conceivably holding out the prospect of a higher financial reward is ownership of a business of their own. But such a business would have to be both large and very profitable to yield a total income (salary and profit) in excess of what these men can now secure from their salary and bonus and from investing such accumulated wealth as they have in existing securities. There is little indication of much of a movement out of top executive positions into ownership and management of smaller, privately-owned business. Compensation seems to be adequate to retain these men in executive positions. It is large enough, also, to appeal to executives in the lower ranks and to make them strive to reach higher positions.

It is very doubtful whether a higher level of executive compensation would bring forth a much larger supply of executive ability by diverting men from other fields—the professions or government, for example.[21] These other fields hold

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received by Charles Schwab in his last years as chairman of the board of Bethlehem Steel.

[20] This is true not only of presidents and board chairmen but also of most lower ranking executives. See, for example, the figures on compensation of executives below the very top rank on p. 280, below. On the allowance to be made for the tax factor, see the article by Baker cited in note 10, above.

[21] Assuming, of course, that men potentially capable of becoming successful corporation executives are included among those who choose non-business vocations.

considerable non-financial attractions, particularly for the more able men who enter them. As long as financial rewards are considered adequate in terms of a better than average standard of living, men entering the professions and public service are apt to discount heavily the still higher financial rewards available in business.[22] Further, once men are trained in non-business fields, it is frequently difficult for them to change occupations and to move from the professions into business. Such diversion as occurs must take place chiefly among the younger men beginning their careers. This is not so true of the law. Much of the work of lawyers involves business dealings and an understanding of business problems, and many leading corporation executives have had their earlier training in the law.[23]

The following data, taken from John C. Baker's authoritative study of executive compensation,[24] give us some idea of the relations existing between the compensation of the uppermost stratum of the executive hierarchy and that of the remaining executives. The figures present the typical (median) compensation for various ranks of executives in 44 very large industrial corporations in 1936.

Ranking of Executives in Individual Companies	Median Compensation
Highest paid executive	$93,000
Second highest paid executive	64,000
Third highest paid executive	50,000
All other executives (averaged)	24,000[25]
Total executives (averaged)	35,000[25]

[22] However, some tendency for public officials in Washington to take more lucrative positions with private business has been evident in recent years (at least, before America's entry into the Second World War).

[23] See pp. 263-64, above.

[24] John C. Baker, *Executive Salaries and Bonus Plans* (1938), p. 181. I have taken the liberty to borrow freely from Dean Baker's study in this and the following sections of the present chapter. Use of Dean Baker's valuable work, both in the book cited and in various articles, has obviated the need for much laborious statistical work which the present study of financial incentives would otherwise have made necessary. Thanks are due both to Dean Baker and to McGraw-Hill Book Company, Inc., for their generosity in permitting the liberal reproduction of figures from the former's book.

[25] Because of imperfections in the data, Baker warns that these two

The highest paid executive typically received, in these 44 companies, nearly 50 per cent more than the next highest paid. Excluding the three highest paid executives, the average executive compensation in the median company was $24,000 per year, a not inconsiderable figure, although it is

Executive Compensation in 51 Large Industrial Corporations Compared with Certain Other Series, 1928–36[a]
(1929 = 100)

Year	51 Large Industrial Corporations				25 Manufacturing Industries	
	Executive Compensation		Balance Available for Dividends	Dividends Paid	Factory Payrolls	Average Weekly Earnings per Wage Earner
	Total	Three Highest Paid Executives				
1928......	91	93	83	77	90	97
1929.....	100	100	100	100	100	100
1930.....	100	100	51	106	77	91
1931......	85	89	5	77	56	79
1932......	70	71	5[c]	32	36	60
1933......	—[b]	—[b]	17	12	41	62
1934......	72	63	34	42	54	71
1935......	75	63	51	54	64	78
1936......	78	73	71	81	77	86

[a] The first, third, and fourth columns are taken from John C. Baker, *Executive Salaries and Bonus Plans,* p. 178. The second column is from Baker, "Executive Compensation Payments by Large and Small Industrial Companies," *Quarterly Journal of Economics,* Vol. 53 (1939), p. 410. The last two columns are from an article by the same writer, "Fluctuation in Executive Compensation of Selected Companies, 1928–36," *Review of Economic Statistics,* Vol. 20 (1938), p. 72. The figures in the first four columns are medians of relatives for the various companies.

[b] Data not available.

[c] Deficit.

little more than a quarter of the median figure received by the highest paid executive. The men whose compensation is included in this average would be chiefly the functional vice presidents, secretary, treasurer, and perhaps the general counsel. These figures apply only to a selected list of very large industrial companies. The *level* of compensation would be

averages "are to be considered merely suggestive." *Executive Salaries and Bonus Plans,* p. 181.

considerably lower in the railroad and public utility fields, but it is unlikely that the relative differences in the compensation of the various ranks of executives in these fields would differ much from that shown here.

Stability of compensation may be an important factor in determining the strength of the attraction which financial rewards hold for men in executive positions. Available data suggest that executive compensation tends to be relatively stable over the cycle, and the volume of executive employment is even more stable. The table on page 281 compares the fluctuation in total executive compensation in 51 large industrial companies during the period 1928-36 with the fluctuations in certain other variables.[26]

The earnings of executives cannot be said to have fluctuated widely during the great depression.[27] Although net income available for dividends in these 51 large corporations had disappeared by 1932, total executive compensation in the median company in that year was still 70 per cent of the peak figure of 1929-30. Payments to officers did not decline between 1929 and 1930, although net income was cut in half. Dividends fluctuated less widely than net income but dropped to far lower levels during the depression than did the amounts paid to executives. Factory payrolls also fell faster and further than did total executive payments or the compensation of the three highest paid officers. Average weekly earnings of wage earners fell somewhat more than payments to executives

[26] The sample of large industrial corporations was compiled by Baker and includes those industrials in Berle and Means' list of the 200 largest corporations in 1929 for which most of the necessary data on executive compensation were available. The maximum number studied by Baker was 59, but a smaller number was frequently used when particular data needed for certain computations were not available for all 59 companies. These 59 corporations are a reasonably representative sample of the giant industrial companies in which we are primarily interested. It should be noted, however, that no rails or public utilities are included.

[27] No data are available on the compensation paid to the executives of large companies before 1928. The data on executive compensation for *all* corporations are analyzed in S. H. Nerlove, *A Decade of Corporate Incomes, 1920 to 1929* (1931), Studies in Business Administration of the University of Chicago School of Commerce and Administration, Vol. 2, No. 4, Chap. 8. See particularly the table on p. 47 of that volume.

but by 1936 were higher, relative to their peak in 1929, than was executive compensation, either of all officers or of the three highest paid.[28]

Executive employment in these firms was phenomenally stable during the years 1928-36. The 51 companies reported 696 executives in 1929 and exactly the same number in 1932. The median number of executives per company in this sample of large corporations was 13 in 1929 and varied only from 12 to 13 throughout the period 1929-36.[29]

The financial incentives offered by the large corporation to its executives seem to meet the criterion of stability extremely well.[30] Executives have been able to look forward to security of employment, and their earnings have fluctuated far less than the income of their companies or the dividends received by their stockholders. They have also enjoyed greater security, particularly in terms of employment but also of income, than have the great mass of industrial workers.

There is reason to believe that among many corporation executives the desire for security is an important motive. Very probably, it is stronger among the leading executives of large and mature concerns than it was among an earlier generation of "big" businessmen who relied more heavily on the gains

[28] For further analysis of the variability in executive compensation, see John C. Baker, "Fluctuation in Executive Compensation of Selected Companies, 1928-36," *Review of Economic Statistics*, Vol. 20 (1938), pp. 65-75.

[29] See Baker, *Executive Salaries and Bonus Plans*, p. 162. The stability of executive employment here evidenced was not peculiar to these large firms. A broader sample of 100 large and small industrial corporations shows a similar stability of employment between 1929 and 1932. The same, p. 14.

[30] We have dealt only with executives of industrial companies. Analysis of executive compensation among the rails and utilities would undoubtedly show equal or greater stability. In both fields the bonus method of payment is rare. Among operating utilities, executive compensation was almost certainly more stable. As for the rails, there was a downward tendency in employment among general officials in the early thirties, but this was apparently chiefly in the ranks of minor officials, who are not ordinarily classed as executives but who are included in the ICC summary tabulations of salaries. At that, the decline in total compensation (which reflects the decline in employment) was not extreme, while the decline in average salary was very modest. See ICC, Bureau of Statistics, *Salaries of Class I Steam Railway Officials Who Received Compensation of $10,000 or More Annually in . . . 1935* (mimeographed report, February 1937), pp. 42-43.

of ownership for their income. The strength of the desire for security can never be measured with any precision, and we can do no more than guess how much stronger it may have become because of the changes which have taken place in the character and background of our business leaders. It is clear that the large corporation can offer its executives a generous and relatively stable compensation and security of tenure. Further evidence in this and the following chapter suggests that in other ways also the incentives provided by the large corporation are likely to appeal more strongly to the desire for security among executives than to the more venturesome traits on which the spirit of enterprise is supposedly based.

In many industrial companies executive payments have increased substantially since America's war production program got under way in 1940. A sample study by the SEC of 121 large and small companies engaged in war work revealed an increase in average compensation paid between 1940 and 1942 of about 20 per cent.[31] The increases in some companies were far more than this. Personal income taxes during the war have been, of course, considerably greater than during the thirties, and many salary increases after 1940 were intended to offset the higher wartime tax rates.

THE PREVALENCE OF BONUS PAYMENTS

To evaluate the financial incentives available to management, we must know not merely the amount of total compensation but also how much consists of a relatively fixed salary and what part takes the form of bonus payments varying directly and immediately with earnings.[32] Evidence already

[31] *New York Times*, Nov. 28, 1943.

[32] The following study of bonus payments is confined to industrial companies and is based primarily on the studies of John C. Baker already cited. The writer has discovered no cases of bonus payments among the railroads in recent years. Bonus payments among the public utilities are also rare. Only one case was discovered in a group of large utilities in the years 1934-36. A few utility holding companies—for example, Columbia Gas and Electric and North American Company—seem to have paid bonuses in the late twenties and early thirties. In both the specific companies mentioned, however, bonus payments had apparently been discontinued by 1933. These generalizations are based on an examination of registration certificates filed

considered regarding the relative stability of total compensation received by executives suggests that bonus payments, however general they may have been, had only a limited effect in causing wide fluctuations in executive compensation during the 1930's.

Relatively little information is available on the prevalence of bonus plans in the United States prior to the end of the twenties. The earlier history of these plans is shrouded in comparative secrecy. Bonus plans "apparently had their genesis in the minds of those considering wage payments and profit-sharing plans for employees as related to results, which were widely discussed in this country and in Europe from 1875 to 1920."[33] Taussig and Barker found that, in the period 1904-14, not more than 5 per cent of some 400 companies studied had regular bonus plans and raised the question whether American firms might not be wise to adopt more widely the European practice of having executive compensation vary more directly with earnings.[34]

Whatever the earlier history of bonus plans in this country, they had become very common in the United States by the end of the 1920's. The peak of the movement toward widespread use of the bonus came with the culmination of the boom of the twenties, both for the larger corporations in which we are chiefly interested and also for smaller firms with securities listed on the New York Stock Exchange. Of a group of 59 very large industrial corporations, 47 paid one or more executives either a cash or stock bonus in one or more years during the period 1928-36. In 1929, about 40 of the 59 com-

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with the SEC (Forms 10 and 10K), on annual reports filed with the ICC, and on transcriptions of compensation data from various government agencies (chiefly the SEC and Federal Trade Commission).

[33] Baker, *Executive Salaries and Bonus Plans*, p. 194.

[34] Another 8 per cent made additional payments to their executives irregularly. (F. W. Taussig and W. S. Barker, "American Corporations and Their Executives," *Quarterly Journal of Economics*, Vol. 40 (1925), pp. 29, 51. See also Baker, *Executive Salaries and Bonus Plans*, pp. 16, 186.) A study of managerial profit-sharing plans in 1928 found that of 32 plans for which adequate data were available, 7 had been in effect at least 15 years and 4 had been in effect at least 20 years. C. C. Balderston, *Managerial Profit Sharing* (1928), p. 19.

panies paid a bonus in addition to salary to certain of their executives.[85] Of 742 executives reported by these companies, about 49 per cent received bonus payments.[86] The bonus was apparently also prevalent among companies smaller than the giants thus far considered.

Bonus payments declined drastically during the 1930's. Many companies cancelled their bonus plans entirely, and

PREVALENCE OF BONUS PAYMENTS IN TWO SAMPLES OF INDUSTRIAL CORPORATIONS, 1929–36[a]

Year	59 Large Industrial Corporations			100 Industrial Corporations Listed on N. Y. Stock Exchange	
	Number of Companies Having Bonus Plans	Number of Companies Paying Bonus[b]	Percentage of Executives Receiving Bonus[c]	Number of Companies Paying Bonus	Percentage of Executives Receiving Bonus
1929......	44	41	49	62	51
1930......	45	42	51	56	47
1931......	37	29	31	42	30
1932......	33	27	19	26	10
1933......	d	d	d	d	d
1934......	25	14	d	d	d
1935......	22	(16)[e]	d	d	d
1936......	24	(16)[e]	d	d	d

[a] Derived from tables in Baker, *Executive Salaries and Bonus Plans*, pp. 16–17 (for the sample of 100 companies) and p. 216 (for the 59 large corporations).

[b] Information on bonus payments actually made was not available for one company during 1929–34, for three companies in 1935, and for seven companies in 1936.

[c] Information on the total number of executives not available for three companies.

[d] Data not available.

[e] These figures, for 1935 and 1936, are not strictly comparable with those for the prior years because information was available for fewer companies in these two years. See footnote *b*.

payments were curtailed or even disappeared in companies in which bonus plans continued in effect. The table above indicates the extent to which bonus payments were discontinued after 1929.

[85] Baker, *Executive Salaries and Bonus Plans*, pp. 186-87, 216. See also the same, pp. 16-17. Apparently 44 companies had bonus plans in 1929, which would mean that very few made no payments under then existing bonus plans.

[86] Data on the total number of executives in three companies were not available. The same, p. 216.

Of the group of very large corporations, only 24 had some form of bonus plan in 1936, compared to 44 in 1929. Despite improving earnings after 1932, bonus plans were not immediately reinstituted and, as a matter of fact, there was a tendency for companies to give up their bonus plans until 1935. Some companies have re-adopted bonus plans since 1936, but there is little question that such plans today are still not as prevalent as they were in the late twenties.[37]

Naturally, as earnings declined during the thirties, some companies which continued to have bonus plans were unable to make any bonus payments. In 1934, for example, 25 companies had incentive plans of some sort, but only 14 actually made payments under them. In 1929, all but three of the companies having bonus plans actually paid bonuses to one or more executives. The decline in number of companies paying bonuses was even more drastic in the group of 100 small and large industrial companies.

The table on page 288 gives some indication of the relative variability of salary and bonus payments between 1928 and 1932. The data are for 53 companies, from Baker's list of 59 large industrial corporations, for which the necessary data were available.

For all 53 companies, bonus payments had declined by 1932 to 25 per cent of the 1929 figure. Salaries, on the other hand, had fallen very little; they actually rose until 1931. The decline in compensation from 1929 to 1932 was occasioned almost entirely by the decline in bonus payments. The figures for the 36 companies which paid a bonus in 1929 are very revealing. Bonus payments suffered a drastic decline, but salaries were actually increased each year through 1931, and in 1932 they were still somewhat above their 1929 total. Thus the 75 per cent decrease in bonus payments (which in 1929 amounted to 57 per cent of total compensation paid by these 36 companies)[38] led to only a 40 per cent decline in total

[37] As recently as 1942 Baker was able to state that the trend was still away from bonus plans. "Limiting Executive Salaries in Wartime," *Harvard Business Review*, Vol. 21 (1942), p. 52.

[38] Baker, *Executive Salaries and Bonus Plans*, p. 218.

compensation. Executives in companies paying salary only in 1929 suffered a 25 per cent decrease in compensation, compared to the decline of 40 per cent in the companies which were making bonus payments when the great depression began.

VARIATIONS IN EXECUTIVE COMPENSATION IN 53 LARGE INDUSTRIAL COMPANIES, 1928–1932[a]
(Relatives: 1929 = 100)

Year	All 53 Companies			36 Companies Paying Bonus in 1929			17 Companies Not Paying Bonus in 1929
	Total Compensation	Salary	Bonus	Total Compensation	Salary	Bonus	Total Compensation
1928....	89	94	83	87	99	79	94
1929....	100	100	100	100	100	100	100
1930....	96	105	85	92	103	84	111
1931....	78	105	47	76	116	46	87
1932....	62	94	25	59	104	25	75

[a] Taken from Baker, *Executive Salaries and Bonus Plans*, p. 218. The relatives are based on aggregate dollar figures added together for all firms in each group. The figures for total compensation in the first column do not agree with those in the table on p. 281 above for two reasons. First, the number of companies included is slightly different in the two cases. More important, the relatives in this table are based on aggregate compensation for all companies, while the figures on page 281 are index numbers which are averages (medians) of relatives for executive compensation computed for each company in the sample.

The executives receiving bonuses in 1929 were on the average receiving a total compensation considerably in excess of that of men in comparable positions in companies not paying bonuses. The decline in bonus payments during the thirties resulted in bringing the total compensation of these men closer to the level of compensation of those who had not received bonuses in 1929. The figures on p. 289, for the presidents of 55 large corporations, indicate this tendency very clearly. The figures for salary and total compensation are medians.[39]

These and other data available strongly suggest that the bonus is in large part not so much an alternative to straight salary as an addition to it. Executives profit handsomely from the receipt of bonuses in prosperous years, receiving a total

[39] Derived from the same, p. 223; see also the same, pp. 222-25.

compensation which is frequently far in excess of that of men in comparable positions whose compensation takes the form of salary exclusively; but in poor years the base salary is still

	1929 Salary	1929 Total Compensation	1932 Salary	1932 Total Compensation
28 presidents receiving salary only in 1929	$80,000	$80,000	$64,000	$64,000
27 presidents receiving salary and bonus in 1929 ...	75,000	196,000	66,000	88,000

high enough so that these men frequently earn as much as or more than executives in companies without bonus plans. Thus, while bonus payments have resulted in making executive compensation vary more directly with earnings than when only salaries are paid, an additional result has been to increase the average level of compensation, even when poor years are averaged with the prosperous ones.[40]

Determination of the amount of bonus to be paid to individual executives involves two steps: (1) computation of the total bonus fund according to some formula, and (2) distribution of this fund among some or all executives on some prearranged basis. We cannot enter here into a discussion of the various formulae used to determine the size of the total bonus fund.[41] Consideration of which executives generally share in bonus distributions, however, throws light on the nature of the incentives to leadership provided by bonus systems as they have been generally administered in our larger American

[40] The same conclusion is suggested if total executive compensation is compared with earnings in companies paying bonuses and in those which do not. Baker's studies indicate that large companies making bonus payments in 1929 paid their executives a much larger fraction of their earnings in that year than did the companies which relied exclusively on the salary method of payment. The same contrast, though to a less marked extent, seems to hold for the remainder of the period 1928-36. *Executive Salaries and Bonus Plans*, p. 205.

[41] For a brief consideration of this subject, see the same, pp. 200, 209-15. See also, by the same author, "Incentive Compensation Plans for Executives," *Harvard Business Review*, Vol. 15 (1936), pp. 50-55. Size of the bonus fund is ordinarily related in some way to the income of the company, but the actual formulae used vary widely.

corporations. The data in the following table are of interest in this connection.

EXECUTIVES SHARING IN BONUS DISTRIBUTIONS IN A GROUP OF LARGE INDUSTRIAL CORPORATIONS, 1929–32[a]

Number of Companies	1929	1930	1931	1932
Number of companies paying bonus....	39	40	27	25
Number paying bonus to president....	28	32	20	14
Number paying bonus to vice presidents	36	35	22	17
Number paying bonus to treasurer.....	30	30	18	14
Number paying bonus to secretary....	30	28	15	11
Number paying bonus to non-officer directors..........................	13	10	9	6
Number of bonus-paying companies having a chairman of the board......	27	29	17	15
Number of such companies paying a bonus to the chairman............	6	10	2	—

[a] Taken from Baker, *Executive Salaries and Bonus Plans*, p. 202.

Clearly not all executives regularly participate in the distribution of executive compensation under bonus plans. A considerable number of companies in each year did not pay bonuses to their presidents. As a matter of fact, a few more companies paid bonuses to one or more vice presidents than to their presidents. Treasurers received bonuses about as often as did presidents; secretaries received them nearly as often.

Of the officers listed in the preceding table, bonuses are least often granted to the official who usually ranks with or above the president, namely, the chairman of the board. In 1930, about one third of the board chairmen participated in bonus plans. In 1932, *none* of the bonus-paying companies having a chairman of the board included that officer in its bonus distribution.

Between a quarter and a third of the bonus-paying companies made awards to directors who were not officers. Some, if not most, of the directors receiving bonuses were actually operating executives either of the parent or of subsidiary companies and received salaries also.[42] It is not common in this

[42] For example, at least one Standard Oil company—having salaried, full-time directors who function as officers but are not listed as such—is included in Baker's list. Not infrequently the leading executives of major subsidiaries

country for non-salaried, non-officer directors to participate in bonus plans.

The failure to include the chairman of the board in most bonus plans is significant, as is the fact that the president is not infrequently omitted also. In the case of the chairman, the answer lies partly, but only partly, in the fact that men bearing this title are frequently inactive. Most are not completely inactive, and many serve a useful role as elder statesmen—advising the president, presiding at board meetings, aiding in the formulation of some broad policies, helping to determine the compensation of the president and other executives, and so on. Such services are not easily evaluated and may bear little relation to fluctuations in current earnings. The chairman is likely to be a former president—and not infrequently a man of considerable wealth and a large stockholder in his own right. He is very often more interested in the welfare of the company, especially if he has been associated with it for a long time, than in additional compensation for himself. A bonus may mean little to him, particularly if he is well-to-do and relatively advanced in years. He may deliberately disqualify himself for bonus payments by participating in determining the bonus to be paid to the other executives.[43] Similar con-

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serve on the boards of parent companies. They are not listed as officers of the parent company, but they receive salaries, of course, and participate in the parent company's bonus plan.

[43] Bonus plans quite generally forbid "directors or other corporate officers from voting on the plan, selecting participants, or determining amounts, if they [are] eligible for a bonus." (Baker, *Executive Salaries and Bonus Plans*, p. 203; see also p. 247.) Charles Schwab of Bethlehem Steel formulated the bonus plan for his company, and until 1931 apparently determined the amounts paid to other executives, subject to the approval of directors. He believed thoroughly in the value of bonus plans. But he never received any share of the bonuses paid by the company. Schwab was chairman of the board from 1915 until his death. He had been both president and chairman before 1915. (See annual report of the company for 1916; *New York Times*, Jan. 15 and July 3, 1931; Arundel Cotter, *The Story of Bethlehem Steel*, p. 22.) Other interesting examples might be cited. Alfred Sloan, chairman of the board of General Motors and that company's chief executive officer, removed himself in 1938 from the list of officers participating in the company's highly remunerative bonus plan. (See *New York Times*, April 4, 1938.) The action applied to bonus payments in the year 1937, as well as later. Neither Pierre du Pont nor Lammot du Pont, chairman and presi-

siderations are likely to hold when the president does not share in his company's bonus plan.

The foregoing suggests that bonus awards are used even more to retain the interest and stimulate the activities of officers immediately below the rank of chief executive than to provide an additional incentive to the latter. The work of these men can be evaluated in only approximate fashion, but evaluation is less difficult than in the case of the chief executive. More important, perhaps, a good part of the careers of these men is yet before them; they are still in the process of building their personal fortunes; and their loyalty to the firm is likely to be less than that of the chief executive. Many chief executives and directors think that these considerations justify liberal bonus payments in order to retain the loyalty and interest of executives below the very top rank and to provide a supply of seasoned officers from which higher posts can be filled in the future.

The fact that active chairmen and even presidents not infrequently fail to share in bonus payments made by their companies raises the question as to how necessary the bonus is as a financial incentive to the higher forms of business leadership. This question becomes even more relevant when it is remembered that many companies (an increasing number since 1929) make no bonus payments at all. The decline in the use of the bonus since 1929 does not seem to have led to any decline in executive morale or to any tendency for top management to work less hard or less effectively. The conclusion may be ventured that, on the whole, the bonus method of payment, as used in large American corporations, has not led to any substantial increase in the effectiveness with which business leadership has been exercised, either from the point of view of the stockholders or from that of the economy as a whole. There may be important exceptions to this generalization, and the

dent respectively, shared in the du Pont company's bonus distributions in the period 1928-36, the period for which the writer has analyzed the available data.

generalization might not be true at all for businessmen with a different set of motives and backgrounds.[44]

OTHER FINANCIAL INCENTIVES

Some companies have sought not merely to provide an additional financial incentive through bonus payments but by the use of several methods have also attempted to encourage stock ownership by their executives. Such ownership ties the executive more closely to his company and provides an additional link between his income and that of the company.

Bonus payments are sometimes made (usually only partly) in the form of stock.[45] Many companies also have had —in some cases still have—stock-purchase plans, usually covering a wider range of employees than the executive group. In some cases, special plans have existed for executives. A number of these plans have been discontinued since 1929.[46]

Some companies use the stock-purchase option as a means of providing additional compensation to executives and of encouraging increased stock ownership by these men. Under the option plan, individual executives are given the right to purchase specified amounts of stock at a fixed or varying price. Such options may be good for a considerable period of time. The gain to the executive depends upon the extent to which the market price of the stock rises above the purchase price fixed in the option.[47] Such stock purchase options have been not infrequently used. A special study by John C. Baker indicated that from 25 to 35 per cent of the companies that he

[44] For further discussion of the nature and effectiveness of bonus plans, see Baker, *Executive Salaries and Bonus Plans*, Chaps. 9-10, especially pp. 236, 245-49; and the same writer in *Harvard Business Review*, Vol. 21, p. 59; also p. 312, note 28.

[45] Of the 47 large companies in Baker's study which paid a bonus in one or more years between 1928 and 1936, 13 paid some part of the bonus in the form of stock. Baker, *Executive Salaries and Bonus Plans*, pp. 187, 188-89.

[46] Thirty-five of Baker's list of 59 large corporations had employee stock-purchase plans at some time between 1928 and 1936. The same, p. 196.

[47] Of course the gain is only a "paper profit" unless the option is exercised and the stock thus obtained is actually sold. However, if the purchase price is relatively low, the dividend yield may be very handsome.

examined gave options to one or more executives at some time in the period 1928-38.[48] Such plans are more common among retail companies than among large industrial concerns. They are used chiefly under two sets of conditions: (1) when it is necessary to attract new executives to weak or ailing companies for a job of reconstruction, or (2) when it is desired to reward executives in successful companies for past or present accomplishments.[49] Stock-purchase options are not ordinarily used continuously as a regular method of providing additional compensation. Such options have frequently but by no means always been very profitable to the executives concerned. They have sometimes given rise to controversy and litigation; and they seem to have had only limited effect in stimulating executives to more efficient management.

As we shall see in the next chapter, the various methods mentioned for stimulating stock ownership among executives have at best been only partially successful in making the gains of ownership an important financial incentive to business leadership in the large corporation. Before considering further the ownership incentive, however, a significant recent development in executive compensation needs to be noted.

Pension or retirement plans in which executives are included have tended to become more common in recent years. In some cases, executives are provided for in broad plans covering a range of employees wider than the executive group. To an increasing degree, apparently, special pension arrangements are being created for the executive group itself. In some cases, plans are informal; arrangements are made with individual executives as the need arises.[50] The significant point is not the nature

[48] John C. Baker, "Stock Options for Executives," *Harvard Business Review*, Vol. 19 (1940), pp. 107, 121. The sample included 53 very large industrial companies, 53 smaller industrial companies listed on the New York Stock Exchange, and 38 retail companies. In recent years the trend has been away from stock purchase options (Baker, *Harvard Business Review*, Vol. 21, p. 52), although as this goes to press the subject is receiving renewed attention as the result of the granting of purchase options by several prominent companies.

[49] Baker, *Harvard Business Review*, Vol. 19, p. 109. The first seems to be the more common situation giving rise to stock purchase options.

[50] In a special study of executive pension plans, published in 1940, Baker

of these pension plans but the indication that executives are laying increasing emphasis on security in their financial arrangements, and that the composite of financial incentives offered by the large corporation is taking account of this need of and desire for security on the part of corporation executives.[51] In this respect, as in others, the modern corporation executive draws closer to the public official and further away from profit-seeking business leaders of an earlier day. As far as pensions are concerned, the need for security and the use of pensions to meet this need are probably more important among lower-ranking executives than for the chief executive and his immediate subordinates; but the emphasis on security and the use of pension arrangements seem to be gradually extending to "top management," also.

EXECUTIVE COMPENSATION AND BUSINESS LEADERSHIP

The system of financial incentives presented in the preceding pages has an important bearing on how business leadership is exercised in the large corporation. Financial incentives, as well as the size of the large corporation and the organizational problems which have come with bigness, point to the fact that modern business leaders are increasingly taking on the character of professional "hired" managers. Executive

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sent questionnaires to the 59 large industrial companies used in his analysis of executive compensation and to the American Telephone and Telegraph Company. Information was secured from 36 companies. Of these, 27 provided formally or informally for executive retirement compensation in some form, as follows:

Executives covered in plans providing for all employees ..	17 companies
Informal plans applicable primarily to executives	9 companies
Special contract with president	1 company

Three other companies had had formal retirement plans in the past and abandoned them; one of these was revising its plan. Of the six companies never having had plans, three were studying the possibility of some form of pension arrangement. In all, five companies apparently planned to include executives under pension arrangements in the near future. John C. Baker, "Pensions for Executives," *Harvard Business Review*, Vol. 18 (1940), p. 311. For further details, see this entire article.

[51] Recently, the tax factor has also played a role of some importance. Executives have been willing to exchange some part of their present salary, taxed at relatively high rates, for future pensions—when their total income may not be so high and taxes are likely to be lower than they are in wartime.

compensation is relatively stable; bonuses have failed to relate total compensation closely to the results of leadership activity; executive employment is highly stable; and increasingly pensions are being provided executives when they retire. The salaried business leader receives a generous income, and to the size of the reward are added the attractions of security and stability.

This system of incentives is far removed from the classical method of remunerating business leadership in a private enterprise economy. The particular reward of business leadership is supposed to be profits, which link the businessman's remuneration directly and completely to the success or failure of the firm's operations. Profits are a residual fluctuating income, the amount of which cannot be forecast in advance. It is the lure of possibly large profits, which will accrue to himself and not to others, which supposedly attracts the business leader in a capitalist system and generates the dynamic type of business leadership on which economic progress depends.

Only if he is a substantial owner in his business will profits bulk large in the business leader's total earnings. We have already seen in Chapter II that executives generally own but a small fraction of the stock of their companies. These small percentage holdings might conceivably, however, represent very large investments in dollar terms—investments so large that the gains from them might outrank executive compensation in the composite of financial incentives to which management responds. We shall examine the strength of the ownership incentive in some detail in the next chapter.

CHAPTER XIII

OWNERSHIP AND NON-FINANCIAL INCENTIVES

Of the various types of incentives which the large corporation offers to its executive leadership, two important categories remain to be discussed in this chapter. One is ownership income, which arises out of the executive's stockholdings in his firm. The other is entirely non-pecuniary and includes the whole range of non-financial attractions which the large corporation holds out to the individuals who guide its fortunes.[1]

OWNERSHIP AS A FINANCIAL INDUCEMENT

With respect to ownership income, let us consider a series of related questions. How large in dollar terms are executives' stockholdings in their companies? What dividends do they receive from these holdings, and how do such dividends compare with their direct compensation from salary and bonus. Finally, on net balance, how do the total gains of ownership—including both dividends and the prospect of appreciation in principal—compare with direct compensation in the total income of the corporation executive?[2]

On page 275 we presented data on the total compensation received by the 264 leading executives in 149 very large corporations. The value of the ownership stake in their companies of these same men (as of December 31, 1935) is shown in the table on page 298. The data refer only to holdings of stock in the company employing each executive.[3] Holdings of

[1] The "gains of position" mentioned on p. 272 represent another type of incentive. We have made no attempt to evaluate the importance of this kind of pecuniary gain, which results from exploitation of one's position in a firm.

[2] The remainder of this section is based on an article by the writer, "Ownership and Compensation as Incentives to Corporation Executives," published in the *Quarterly Journal of Economics*, Vol. 54 (1940), pp. 455-73.

[3] The stockholdings figures are taken from SEC, *Official Summary of Holdings of Officers, Directors and Principal Stockholders . . . as of Decem-*

common and of all stock are shown separately.

DISTRIBUTION OF 264 EXECUTIVES ACCORDING TO MARKET VALUE OF STOCK OWNED IN EMPLOYING COMPANY, BY INDUSTRIAL CLASSES, DECEMBER 31, 1935[a]

Value of Stock Owned[b] (Unit: $1,000)	Number of Executives							
	All Stock				Common Stock Only			
	Industrial	Public Utility	Railroad	Total	Industrial	Public Utility	Railroad	Total
0	8	3	8	19	13	3	15	31
0– 10	14	17	31	62	12	18	27	57
10– 20	7	2	3	12	8	2	1	11
20– 30	5	1	3	9	7	2	5	14
30– 40	1	4	1	6	1	4	1	6
40– 50	2	2	—	4	4	2	—	6
50– 100	18	5	2	25	18	4	—	22
100– 150	10	2	2	14	10	2	1	13
150– 200	5	1	—	6	6	1	—	7
200– 250	5	4	—	9	6	4	—	10
250– 500	21	4	—	25	15	4	—	19
500– 1,000	19	1	—	20	22	1	—	23
1,000– 5,000	32	5	1	38	26	4	1	31
5,000–10,000	9	1	—	10	8	1	—	9
10,000 and over	5	—	—	5	5	—	—	5
Total men	161	52	51	264	161	52	51	264
Median[c] (Unit: $1,000)	298.7	37.4	1.2	90.0	226.3	33.0	0.2	71.6

[a] Derived from a table in R. A. Gordon, "Ownership and Compensation as Incentives to Corporation Executives," *Quarterly Journal of Economics*, Vol. 54 (1940), p. 461. Market values of stock held are based on closing prices for Dec. 31, 1935, or the nearest available date. In some cases, where no actual prices were available, bid quotations were used; and in a few cases book values per share (as derived from balance sheets) were used in lieu of market prices.

[b] Lower limit of class interval inclusive except in 0-10 group, which should be read as "more than 0 but less than 10."

[c] Medians are based on the original arrays.

These figures suggest that, at least for industrial companies, it is not correct to assume that executives have little or no

ber 31, 1935. In a few cases, reports filed with the Commission were consulted directly. These data are subject to certain imperfections which probably lead to some understatement of holdings. (See Gordon, *Quarterly Journal of Economics*, Vol. 54, p. 458.) More recent figures on executive ownership are available in TNEC Monograph No. 29. Since compensation data had been already compiled for 1935 before the later stockholdings data became available, the earlier data on ownership were used. It was necessary to have figures on both ownership and compensation for the same year; otherwise the needed comparisons could not have been made.

ownership stake, in dollar terms, in their companies. In the industrials, 46 out of 161 executives, more than a quarter of the total, each held stock (common and preferred) to the value of 1 million dollars or more. The median holding was $298,700. On the other hand, 37 men held stock with a value of less than $50,000, including eight who held no stock at all.

Among the chief officers of the railroads the situation is very different. Only five of these men (out of 51) owned stock to a value of $50,000 or more, and the median holding was as low as $1,200. The public utilities present an intermediate picture. Approximately one third of the public utility executives owned stock to the value of $100,000 or more, but the median was only $37,400, about one eighth of the corresponding figure for industrial executives. For the men in all three groups combined, the median was $90,000. Fifty-three men (of whom only seven were in rails and utilities) showed holdings of a million dollars or more.

The holdings among the men in all three industrial groups were primarily in common stock. This is to be explained in part by the fact that in many of the concerns no preferred issues were outstanding; but even after full allowance is made for this element, it is still true that these executives preferred to invest in common stock, with the additional opportunities for speculative enhancement in value which this type of security provided.[4]

The contrast in the value of the holdings of the executives in the three industrial groups is similar to that noted in Chapter II when we were considering percentage stockholdings. The very small holdings (by almost any standard) of the high officials of our leading railroads is particularly to be noted. The financial plight of many railroad companies provides one explanation; perhaps these men, in view of their familiarity with the industry, would be the last to invest substantially in railroad junior securities. The background of the men themselves provides a partial explanation; many, if not

[4] See Gordon, *Quarterly Journal of Economics*, Vol. 54, p. 462.

most, have come up through the ranks and probably few are very wealthy men. In the railroads, perhaps more than in any other industry, we have the "hired manager" type of professional executive, performing a largely routinized function. These conditions make for a relatively small ownership, and the poor investment rating of railroad securities has accentuated the tendency.

DIVIDENDS RECEIVED BY EXECUTIVES FROM STOCK OWNED IN EMPLOYING COMPANY, BY INDUSTRIAL CLASSES, 1935[a]

Dividends[b] (Unit: $1,000)	Number of Executives			
	Industrials	Public Utilities	Railroads	Total
0	47	24	43	114
0– 10	54	19	7	80
10– 20	16	4	—	20
20– 30	6	1	—	7
30– 40	5	2	—	7
40– 50	1	—	—	1
50– 75	10	2	—	12
75– 100	7	—	1	8
100– 150	1	—	—	1
150– 200	1	—	—	1
200– 250	5	—	—	5
250– 500	3	—	—	3
500–1000	2	—	—	2
1000 and over	3	—	—	3
Total executives	161	52	51	264
Median[c]	$2,980	$90	0	$500

[a] This table is from an article by the writer in *Quarterly Journal of Economics*, Vol. 54 (1940), p. 463. Dividend income is computed by multiplying stock held on Dec. 31, 1935, by the dividend rate for 1935, as given in Moody's investment manuals.

[b] Lower limit of class interval inclusive except for the group 0-10, which should be read as "more than 0 and less than 10."

[c] Medians are based on the original arrays.

The table above offers further evidence concerning the importance of the ownership stake of these leading executives. From this table we may get some idea of the dividend income which these men received from the stock, the values of which were shown in the table on page 298.[5] The dividend

[5] We have no record of dividends actually received. The table on dividends indicates the dividend income these men *would* have received, had they held throughout the year the stock which they owned on Dec. 31.

figures, even more than those on value of stockholdings, suggest that in the majority of cases ownership is not a major source of income, even to the leading officials of the industrial firms. The median annual dividend income for industrial executives was only $2,980, and for officials of utility and railroad companies the figure was negligible or actually zero. For all 264 men together, the median figure corresponded to an annual income of only $500. Thirty-five men in all (about 13 per cent) received dividends of $50,000 or above. All but 3 of these were in industrial companies. All dividend incomes of $100,000 or over, 15 in number, were received by executives of industrial concerns.

If the figures on dividends had been taken for some later year, rather than 1935, the dividend incomes shown (for the same amounts of stock) would not have been changed enough to alter the main conclusion to be drawn from the table.[6] On the whole, we may safely rely on the interpretation given above. Whatever the importance of ownership as a source of capital gain for these executives, dividends from stock held in their companies are not an important source of income to the great majority of them.

This conclusion, of course, should be tested by reference to the salaries and bonuses that the men received. The data on total executive compensation for this same group of executives were given on page 275. Comparisons will be facilitated if the medians for the three distributions in which we are interested—total executive compensation, value of stock owned, and dividends from stock owned—are all brought together. This is done in the following set of figures:

	Industrials	Public Utilities	Railroads	All Executives
Value of stockholdings .	$298,700	$37,400	$1,200	$90,000
Dividends	2,980	90	0	500
Compensation	79,200	48,600	40,600	61,200

On the basis of the evidence cited, salary and bonus seem clearly to be the dominant financial incentive. For the railroad

[6] See p. 303.

officials, the case is perfectly clear, and the situation is not greatly different for the public utility executives. It should be noted, however, that about one third of the public utility executives had value-holdings of $100,000 or more (page 298). For this group, particularly those with holdings of more than, say $250,000, the possibilities of capital gain may have been substantial; and to some of this group ownership may have supplied a more important inducement than compensation. This cannot, however, be regarded as the typical case among these public utility executives.

As already noted, leading industrial executives have a far greater ownership stake in their concerns than have the leading officials of the other two groups. But the median dividend is not even one twenty-fifth of the median compensation figure. Even at the higher dividend rates prevailing in 1936 and 1937, the median dividend income for the industrial executives probably did not rise to as much as 10 per cent of the median compensation in 1935.[7] For some industrial executives, however, dividends were clearly an important source of income. Thirty-two (about one fifth) had a dividend income of $50,000 or more (page 300). For nearly the same number, 31 in all, dividend income amounted to at least half the total salary and bonus.[8] In 18 cases, about 11 per cent, dividend income was equal to or greater than executive compensation.

To a moderate minority of the industrial executives, then, dividends loom large in the composite of financial attractions available. To the great majority, however, though dividends may provide a welcome minor addition to total income, they are relatively unimportant compared with salary and bonus.

Among the financial attractions connected with ownership for the industrial executives, the possibilities of capital gain or loss probably play a more important role than do dividends. The median value-holding was $298,700. This figure, in and

[7] The table on p. 303 gives an index of dividend rates for companies in all three industrial groups together. For industrial companies only, the dividend index would be: 1935—100; 1936—133; 1937—184; 1938—118.

[8] Based on a study of the original arrays, not the frequency series in the tables presented in this and the preceding chapter.

of itself, represents a modest fortune and opens up possibilities of substantial gain or loss in dollar terms (if only "on paper"). For the one quarter of the industrial executives whose stockholdings alone were enough to make them millionaires, ownership must clearly be ranked, if not on a par with compensation, certainly as a very important element among financial incentives available to them. For the majority of the 161 industrial executives, the expected gains from ownership were probably not so important as compensation, though the incentive provided cannot be ranked as insignificant.

SELECTED INDICES OF STOCK PRICES, DIVIDEND RATES, AND EXECUTIVE COMPENSATION, 1934–38[a]

All indices are on the base 1935=100 except that for stock prices, which is on the base December 1935=100)

Year	Stock Price Index (High and Low Monthly Average)	Average Dividend Rate	Index of Executive Compensation for Selected Large Industrials	
			Three Highest Salaries	All Executives
1934.......	71– 85	91	100	96
1935.......	68–100	100	100	100
1936.......	105–130	123	116	107
1937.......	86–136	159	—	—
1938.......	74– 99	113	—	—

[a] Taken from Gordon, *Quarterly Journal of Economics*, Vol. 54 (1940), p. 468.

All these comparisons have been made on the basis of figures for a single year or day. Hence we must consider how different the above results would have been had the data been taken for a different period. The table above shows variations in stock prices and dividend rates for the five-year period 1934-38, together with an index of executive compensation for 1934-36. Data on stock prices and dividends might have been presented for a longer period, but the conclusions to be drawn from the table would remain essentially unchanged.

It has not been possible to present a series showing the extent to which these executives added to or subtracted from their holdings.[9] These holdings have probably not changed

[9] Such data could have been compiled at a great cost in time and money from monthly reports filed with the SEC.

sufficiently since 1935 to alter in any substantial degree the medians already presented.[10] But changes in the level of stock prices undoubtedly did make a difference. The highest monthly average in 1937 was 36 per cent above the level of December 1935. An increase in this percentage would have raised the median value holding of industrial executives to about $400,000; multiplication by the low figure for 1935, however, would reduce it to about $200,000. For the other two industrial groups, these swings in stock prices, of course, were of considerably less significance, in view of the much smaller stockholdings involved. As far as the industrial executives are concerned, if they retained their shareholdings throughout this period, they stood to incur, on the average, fairly large paper losses or profits; but, on the whole, what we have said about the relative importance of ownership, compared with compensation, is not changed by using the stock prices of some other day or month during the years 1934-38. Nor would our general conclusions regarding the relative importance of the ownership incentive be significantly altered by using data for some year since 1938.[11]

Executive compensation, at least for industrial companies, was rising gradually from 1934 through 1936, but the figures show no startling changes. Later figures are not available in detail, but we have already commented upon the relative stability of executive compensation—also on the increases which occurred during the war years. On the whole, we may conclude that 1935 was a reasonably good year to use for our comparisons, and that the conclusions reached would not have been seriously altered had some other period in the years 1934-38 or even later been chosen for study.

[10] On the whole, if anything, stockholdings by executives are probably somewhat smaller now than in 1935.

[11] The highest and lowest monthly figures for the stock price index in the period 1934-38 were, respectively, 136 and 68. From 1939 through 1942, no higher monthly figure occurred; the low for the index was 63. The dividend index did not go above 148 from 1939 through 1942. These figures are derived from *Survey of Current Business*, the indices there given being adjusted to the bases used in our table, namely, December 1935, for stock prices and the year 1935 for dividends.

NON-FINANCIAL INCENTIVES

The attractions which the large corporation holds out to the business leader do not stop with purely monetary rewards. The businessman, like all human beings, is moved by various impulses, many of which can be satisfied without the receipt of a money income. By non-financial incentives, we mean the non-monetary attractions which contribute toward the satisfaction of the urges or desires that lead businessmen, or any group, to engage in economic activity. (The desires themselves are sometimes referred to as "economic motives.")

The most important spurs to action by the businessman, other than the desire for goods for the purpose of direct want-satisfaction, are probably the following: the urge for power, the desire for prestige and the related impulse of emulation, the creative urge, the propensity to identify oneself with a group and the related feeling of group loyalty, the desire for security, the urge for adventure and for "playing the game" for its own sake, and the desire to serve others. While this list is not complete, the motives mentioned probably constitute the important ones for a study of the psychological drives motivating business leaders.[12] These motives can be satisfied more or less through monetary rewards. They can also be satisfied in good part by other attractions which the large corporation offers its business leaders.

One of the most important of the non-financial incentives offered by the large corporation is the opportunity to satisfy the urge for personal power.[13] The corporation executive possesses power by virtue of his position of authority in a firm

[12] For other compilations of economic motives, see Z. C. Dickinson, *Economic Motives* (1922), Chap. 19; F. W. Taussig, *Inventors and Money-Makers* (1915); C. I. Barnard, *The Functions of the Executive* (1938), pp. xi, 142-49; J. C. Baker, *Executive Compensation Practices of Retail Companies, 1928-37* (1939), publication of the Graduate School of Business Administration, Harvard University, Vol. 26, No. 4 (July 1939), pp. 1-2. See also, for some discussion of the importance of non-pecuniary motives, P. S. Florence, *The Logic of Industrial Organization* (1933), Chap. 7, and *Economics and Human Behavior* (1927); T. N. Whitehead, *Leadership in a Free Society* (1936); and R. H. Tawney, *The Acquisitive Society* (1921), Chap. 9, sec. (c).

[13] See, for example, TNEC Monograph No. 11, pp. 64-65.

which itself is powerful. His power is a product of position rather than of personal wealth.[14] Power in this case means authority over subordinates, control of the disposal of vast resources, and great influence over persons and affairs outside the firm. The corporation is the vehicle through which power comes to be held and exercised. The analogy between the power thus held by the corporation executive and that held by the public official is too close to require elaboration.

Power thus secured increases with the size of the firm. Here lies an important explanation of the tendency of many large firms to become larger, even if sometimes the profitability of such expansion is open to serious question. The working of the power urge in this respect is reinforced by the tendency of businessmen to identify themselves with their enterprises. Expansion is desired for the enhancement of personal power and also because of the satisfaction of being associated with a powerful organization.

The drive for personal power also plays an important role in owner-managed businesses, where it can be satisfied through both the power of money, if profits are large, and the power of position. The workings of the power urge can be seen, too, among directors and among the outside "control groups" which are in a position to influence the affairs of particular firms.[15] For our present purposes, however, the important point is that the corporation, through the opportunities for power that go with positions of authority, can offer an important non-financial incentive to its executives which is a substantial substitute for the receipt of personal profits.

[14] Compare the following: "The management has an interest in the business different from that of any investor. That interest is the management status which is significant in terms of control. Control is all-important. It means salaries and prestige. It means power to dispense normal business patronage to affiliated interests. It has been likened to a feudal tenure with rich incidents accruing to it." SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, Pt. 7, p. 11.

[15] The consolidation activities of the elder Morgan, for example, are more easily explained in terms of the urge for power than of the desire for personal income.

The large corporation can also offer prestige, over and above that which results from the executive's receipt of a large salary and bonus. Power itself brings prestige, as does the mere fact of heading a large and successful firm. As in the case of personal power, prestige is to some extent linked with the size of the firm, and too strong a desire for it may lead to overexpansion. The prestige which is based on position is certainly considerably greater than that which comes from the receipt of a large salary.[16]

The large corporation offers the executive ample opportunity for the satisfaction of the creative urge.[17] This motive among businessmen, including corporation officials, must not be underrated.[18] The urge to construct, invent, and create carries over into the field of business, where it takes partly a technological turn—for example, in an emphasis on technical efficiency , quality of product, and effectiveness of organization. Thus a businessman may seek to lower costs and improve production methods not merely because of the higher profits which may ensue but also because of the desire to do a job well for its own sake. On the whole, this tendency may per-

[16] Alfred Sloan suffered no loss in prestige when he removed himself from General Motors' bonus plan, thereby reducing his total compensation substantially. Nor did the total compensation of more than $300,000 paid to the vice president of a large merchandising concern in 1935 give that individual thereby the prestige in the business world enjoyed by the chief executives of some of our largest, most successful corporations who received a much smaller compensation. To cite another case, Walter Gifford's position in the business world does not depend on the salary he receives, which, though large, is smaller than that paid the chief executives of a number of other companies. The crucial fact is Mr. Gifford's position at the head of the largest non-financial business enterprise in the United States.

[17] This urge has been given a variety of titles. It was popularized by Thorstein Veblen as the "instinct of workmanship." (See his *The Instinct of Workmanship* (1914).) Taussig, apparently following McDougall, called it the "instinct of contrivance." (See *Inventors and Money-Makers*, p. 11.) Some writers speak of a "creative instinct" or "creative impulse."

[18] As one example, among many, the following might be cited. Alfred Sloan is quoted as having said as early as 1927: "Making money ceased to interest me years ago. It's the job that counts." (*Fortune*, March 1938, p. 45.) This probably represents some overstatement, even in Mr. Sloan's case. For most men "making money" for themselves is extremely important, but they would agree that "the job counts," also.

haps be found somewhat more among corporation executives than among owner-entrepreneurs.

Primarily the creative urge in business takes the form of seeking to develop a successful business enterprise. Success in business is measured by solvency and profits. The most important criterion of "creativeness" in the business world, the primary yardstick by which the business leader measures the effectiveness of his work, is the size of his firm's earnings.[19]

This is true of corporation executives as well as owner-managers operating their own enterprises. The executive will use profits in evaluating the results of his leadership, even if he is not an important owner of the business. The mere existence of profits indicates that his work has been well done, though the earnings are distributed to others.

The top executives of a large firm, however, are probably not as closely tied to the profits criterion of creativeness as are owner-managers. While they may lay primary emphasis on the yardstick of profits, they can follow their creative impulses in other directions, also, even if the result is not immediately realized larger profits for the firm.

As we have already noted, there is a marked tendency among businessmen to identify themselves with their enterprises, whether or not they are important stockholders. The propensity to identify oneself with a group or organization was one of the "economic motives" mentioned on page 305.

This characteristic is an important factor in explaining the behavior of corporation executives, as well as of owner-entrepreneurs. The professional executive may think of himself as working more for "his" firm than for a large body of stockholders, most of whom are strangers to him. This is

[19] This suggests that the quality of modern business leadership can be improved, and business leaders induced to give more attention to the broad economic and social consequences of their leadership, not so much by strengthening the creative urge—which is already strong—as by establishing and educating businessmen to accept new criteria of what constitutes for the business leader "a job well done." This would involve substituting the point of view of the economy as a whole for that of the firm or individual, at least to the extent that the former is not compatible with the latter. See also pp. 338-42.

more likely to be true if he has spent many years with the company. Not infrequently the corporation becomes a living entity on which the business leader (executive as well as owner) lavishes a devotion which is both selfish and self-sacrificing.[20] Profits are reinvested in the business for the sake of bigness and to protect the position of the company, and the interests of the stockholders may be given second place to the business leader's conception of what is best for the firm itself.[21]

Thus, even among many corporation executives, ambitions of the individual business leader are likely to shift in part from the personal to the impersonal plane. Personal ambitions become transmuted into a powerful desire to serve the business enterprise itself as an independent and living entity. It is easier in many respects to direct one's loyalty to the firm itself than to a large and, in good part, anonymous body of stockholders. The executive not infrequently tends to look upon the stockholders as outsiders, whose complaints and demands for dividends are necessary evils, which must be reconciled with what is considered best from the point of view of the business itself as a continuing institution having an existence apart from that of its owners.

Two consequences of this attitude among top corporate managements are a predisposition in favor of continued expansion and a general unwillingness to liquidate unsuccessful enterprises. We have already commented upon the effects of the power urge in leading to corporate expansion. The same

[20] Charles Schwab's relations with Bethlehem Steel are one example. Schwab apparently looked on the company as in some sense belonging to him even after his stockholdings had been considerably reduced. He was also reported to have said, when he was 72 years old, that he would never retire from the company's chairmanship. (See Arundel Cotter, *The Story of Bethlehem Steel; New York Times*, Jan. 15, 1931, Mar. 4, 1931, and Apr. 15, 1931; *Fortune*, April 1934, p. 196.) F. A. Seiberling, founder and head of Goodyear Tire and Rubber until 1921, also acted as if he and the company were one. (See H. and R. Wolf, *Rubber*, p. 450.) Both of these men were founders of their companies, but similar attitudes can also be found among many more "professional" executives.

[21] See Herbert von Beckerath, *Modern Industrial Organization, an Economic Interpretation* (1933), pp. 14, 68-69, 71.

tendency arises to some extent out of executives' identification of themselves with their firms. The firm as well as the individual must be strong and powerful. Similarly, corporate managements seldom consider liquidation an alternative to unprofitable operations. The chief executive who has been long with his company rebels against the idea of "his" firm's passing out of existence. Relevant here also is the vested interest the individual has in his position in the company, and he will ordinarily seek to preserve in reorganization proceedings.[22]

The desire for adventure and the urge to play the game for its own sake may be satisfied in the large corporation as well as in smaller enterprises managed by their owners. The stakes in large-scale corporate activity are high, and lack of ownership is not necessarily a bar to an executive's getting a thrill out of the game of business. There is the thrill of playing for personal success, and also the thrill of playing for high stakes, even if with "other people's money." On the other hand, the large, mature firm—with its problems of internal organization and its need to move slowly—may not be able to satisfy the more venturesome business leaders. Especially if increased government regulation and routinization of internal operations are concomitants of growing size, the thrill of adventure involved in the direction of a large firm may be substantially diminished.[23] The larger and more successful the firm and the fewer the worlds yet to be conquered, the less scope does the corporation offer for the play of this motive.

It is probable that the spirit of adventure is less strong among modern business leaders than among those of an earlier generation. The professionalization of management and some increase in social responsibility have led to a decrease in the desire for adventure for its own sake. The character and background of our business leaders has changed, with the result

[22] See, for example, SEC, *Report on the Study and Investigation . . . of Protective and Reorganization Committees*, especially Pt. 7, p. 11.

[23] See Miriam Beard, *A History of the Business Man* (1938), pp. 723 ff., especially p. 727, for a somewhat overdrawn characterization of the effects of corporate size and bureaucracy on the character of modern business leadership. See also TNEC Monograph No. 11.

that greater emphasis is placed on education, training, and a "scientific approach" and less on rugged, venturesome, and frequently heedless individualism.[24] The desire for security seems to have increased, and the concomitant of a growing emphasis on security is a diminishing desire for adventure for its own sake.

As we have seen, the large corporation caters effectively to this desire for security. The executive's compensation is relatively stable, and he is likely to have a high degree of security of tenure. Wholesale purges of the executive ranks are rare, and top management, usually securely in control of the proxy machinery, seldom has to worry about retaining its position.

The last of the motives mentioned on page 305, the altruistic urge, needs only brief mention here. While the opportunities in the business world for service to others are, in one sense, boundless, insuperable obstacles to giving free play to this motive arise from the exigencies of profit-making.[25] Those who feel this motive most strongly are less likely to choose business as a career than public service or one of the professions. In general, the motive is strong among businessmen chiefly in their non-business activities. Neither the large corporation nor the small business provides a great deal in the way of opportunities for the satisfaction of the altruistic urge.[26]

In some respects, however, the large corporation is providing a setting within which greater stimulation of this motive

[24] See F. W. Taussig and C. S. Joslyn, *American Business Leaders*, especially Chaps. 15, 17, 20, for an analysis of the backgrounds of modern business leaders. The change in the character and background of the leaders of the old Standard Oil Trust as the first generation of leaders dropped out is described in Allan Nevins, *John D. Rockefeller*, Vol. 2, p. 443.

[25] Even as judicious a person as Taussig, who was far from being a muckraker, doubted the strength of the motive among businessmen, although he did express hope for the future. *Inventors and Money-Makers*, pp. 132-34.

[26] It might be said that a business leader's devotion to his enterprise represents altruism of a sort, since it may involve some sacrifice of self for other reasons than conscious hope of personal reward. (See Taussig, *Inventors and Money-Makers*, p. 115.) We have already pointed out that such devotion may be self-sacrificing, but also selfish at the same time. In the text, we have in mind a broader type of altruism, in which the desire to serve others extends beyond the enterprise itself.

may become possible. Management is becoming professionalized, and leadership is being divorced from profit-receiving if not from profit-making. The economic ills of recent years, tendencies toward increased government regulation, and the Second World War have all forced businessmen, particularly large-scale business leaders, to widen their economic horizons and to accept, albeit reluctantly, increased social responsibilities. Out of these tendencies may result some increase in the positive desire of corporate business leaders to subordinate their personal interests and those of their firms to the welfare of the community as a whole.[27]

THE INCENTIVE SYSTEM OF THE LARGE CORPORATION

It is clear that the large corporation offers a wide range of incentives to the executive group—from salary and bonus (chiefly salary) to a variety of non-financial attractions. However, the traditional reward of the business leader—the profits arising from business ownership—is not a primary incentive to the majority of top executives in our largest corporations.[28]

[27] See note 39 on p. 342.

[28] One might maintain that bonus payments are a form of profits and should be included with ownership income in evaluating the importance of profits to the executive. Without arguing the point, we may remark that: (1) salary is a much more important form of executive payment than bonus; (2) bonus payments have not caused executive compensation to vary as widely as company earnings; and (3) unlike profits, bonuses never become negative. (As a matter of fact, as we saw in Chap. 12, declining bonus payments are sometimes partially offset by increasing salaries.)

The writer does not believe that large firms would be wise to use more extensively bonus and stockownership plans for executives. Such plans do not automatically convert salaried executives into owner-entrepreneurs, and they are too open to abuse to be worth the limited results likely to be achieved in stimulating large-scale leadership. We saw in Chap. 12 that it does not follow that stockholders always benefit from the use of bonus plans or suffer because such plans are not in effect in many companies. Bonus arrangements in some cases would widen rather than narrow the gap between executives' and stockholders' interests. The same can be said of the use of stock purchase options. As far as bonus plans are concerned, the correlation between individual bonus payments and the results of the leadership activity of particular executives is sufficiently tenuous that we may seriously question whether wider use of bonus payments would lead to a much more dynamic and flexible type of leadership. Where salary payments are sufficiently liberal to begin with, there is some question also whether additional payments in

While it is true that the stockholdings of many high-ranking officials, chiefly in industrial companies, are substantial in dollar terms, executives generally rely more on their direct compensation than on the gains of ownership for their monetary remuneration. And, in terms of the personal desires which motivate businessmen, the non-financial attractions offered by the large corporation also frequently outrank profits as an incentive for the salaried business leader.

Monetary compensation is becoming largely a minimum condition for attracting the necessary supply of business leadership in the large corporation. Executives' salaries must be high enough to permit a generous standard of living and to enable them to make financial provision for their families. Beyond this, however, the large corporation does not ordinarily have to provide remuneration large enough to satisfy, through the accumulation of a personal fortune, the desires for power and prestige.[29] Nor does the large firm have to offer its financial incentives in the form of profits to attract the

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the form of bonus provide as strong an incentive as do the various non-financial attractions that we have mentioned.

If large American corporations are to use the bonus system more extensively, the following suggestions may be made. If bonus payments are to be related to total company earnings, the basic fixed salary should be very low. Otherwise the bonus becomes more a means of increasing average total compensation than a means of making compensation flexible. Secondly, bonus payments probably serve a more useful purpose in the lower, rather than the higher, executive ranks. For such lower ranking officials, it would be preferable to relate bonus payments to measures of individual performance (where this is possible) than to total company earnings.

There is also doubt as to how far executive stock ownership plans can be successful in restoring the profit motive to professionalized business leadership in the large corporation. Executive ownership is not an effective incentive unless the gains from ownership are comparable in size with those received from salary and bonus. Where executives are not already important owners, it would be difficult to give them sufficient ownership without jeopardizing the interests of stockholders; and again the question would arise as to the relation between the reward and activities of particular executives.

[29] Sometimes a large personal fortune is wanted for this purpose, and accumulated wealth may be desired for other reasons, also, for example, to provide particularly well for one's family. However, a large salary provides considerable opportunity for accumulating personal wealth, and the executive's family can be further protected through life insurance.

necessary leadership. Given an adequate salary, the non-financial incentives mentioned seem to provide a sufficiently strong inducement.

The comparatively stable salary earned by executives and the non-financial attractions offered by the large corporation are both related in much the same fashion to the profits which accrue to the enterprise. The more profitable the concern, obviously, the larger are likely to be both monetary compensation and the non-financial attractions. But the correlation of both sets of rewards with profits is at best imperfect. The non-financial rewards, like salary, are relatively inflexible; they do not vary with every change in the company's earnings; and, unlike the case of profits, there is not the constant possibility that gain will be succeeded by loss. On the other hand, there is not the same upper limit on the non-financial incentives as has been imposed on salaries. The opportunities for personal power and for creative work are, if not limitless, certainly very great. In this respect, non-financial rewards may provide a more powerful stimulus than monetary compensation to the business executive in the large corporation. However, for a minority of more dynamic, aggressive business leaders, the non-financial attractions mentioned probably provide less of an incentive than do the personal receipt of profits and a large personal stake in the business.[30]

We have confined ourselves to a discussion of incentives available to executives. Non-officer directors receive very little monetary compensation. Their salaries are nominal (usually merely small fees for attending directors' meetings), and they do not ordinarily share in bonus payments.[31] However, their stockholdings on the average are likely to be somewhat larger than those of executives, though still small as a fraction of the

[30] In addition to profits, a controlling ownership interest in his firm provides the aggressive leader with the further stimulus that he is free to manage the concern largely as he pleases (subject to legal and other checks) and that he is not accountable to directors and stockholders to the same degree as is the executive without such ownership.

[31] See p. 290, above. There has been some tendency in recent years to pay salaries to directors, but the movement has not yet made much headway.

total stock outstanding.[32] Hence, so far as they are motivated by the prospect of personal financial reward, directors in the largest firms tend to be attracted more by the profits of ownership than by salaries and fees. The desire to protect their stake in an enterprise—and the stake of friends and relatives—is the chief reason a number of men accept directorships.

While directors may generally look more to their ownership than to nominal salaries and fees for their financial reward, the stockholdings of most directors are not very large. The evidence presented in Chapter VI suggests that only a minority of the non-officer directors of very large firms serve on boards because of large stockholdings owned either by themselves or by interests they represent. Most outside directors are probably motivated by one or both of two factors, in addition to the stockholdings they may own or represent—their (chiefly financial) interest in some activity affected by the corporation's operations (bankers are an example) and by such non-financial incentives as power, prestige, or friendship for and loyalty to a particular group of individuals. While it obviously cannot be precisely evaluated, the non-financial stimulus is unquestionably very important for a great many directors. On net balance, the personal receipt of profits is probably not the primary incentive for the majority of non-officer directors in the large corporation. As we saw in Chapter VI, the amount of leadership by these men, whatever their incentives, is very limited.

Among the interest groups in a position to act as business leaders in the large corporation, only the stockholding group finds in profits its chief incentive. Here the primacy of the "profit motive" is unquestioned. A minority group's interest in a firm arises out of its ownership, and the influence and leadership of the group is directed toward protecting this interest and in maintaining and enhancing the profits it receives from the firm. The minority group which actively participates with management in business leadership represents

[32] See the table on p. 27, above.

one of the closest approximations the large corporation offers to the profit-receiving entrepreneur.[33] Even this is only an approximation. The leadership role of the minority group is ordinarily limited, and a good part of the profits of the firm go to the other, less active stockholders.

[33] A closer approximation would be the chief executive owning a substantial fraction of his company's stock and thus relying far more on profits than on salary for his income. Such cases exist, but they are not numerous among our largest corporations.

CHAPTER XIV

THE PROFESSIONALIZATION OF BUSINESS LEADERSHIP

In Chapter I, we stressed the importance of the function of business leadership in our complex, dynamic, and closely articulated economic system. We emphasized the fact that, particularly in the large firm, the business leader's decisions are not necessarily predetermined by underlying economic forces. What he does and the decisions he makes depend in part upon the kind of person he is, the leadership organization within which he operates, the institutional pressures which bear upon him, and the incentives to which he reacts. The wider the range of alternatives which underlying economic forces leave open to the business leader, the more important are the institutional, organizational, and personal factors mentioned to an understanding of why our business leaders act as they do. We therefore asked the question: Who does exercise the function of business leadership in the large corporation, with its hierarchy of delegated responsibility and with a variety of groups competing for power and influence in the firm's affairs? Part II was devoted to answering this question. We considered in turn the leadership activities of executives, directors, and each of the important interest groups associated with the large corporation.

Our chief findings in this connection have already been stated. In the very large corporation of today, the main elements of business leadership are exercised by the executive group. This general conclusion is subject to some, but essentially only minor, modifications as a result of our study of the power, influence, and activities of directors, minority stockholders, bankers, and the other groups considered in Chapters X and XI.

When we speak of the "executive group," the second of these two words needs to be stressed. The chief executive is

the most important single figure in the large corporation, but he is only one of a sizable body of professional managers who individually and collectively make the decisions and provide the co-ordination that give unity and direction to the firm's activities.

The primary responsibility for business leadership in the large corporation has devolved upon a group of men who are professional managers. Their position is not achieved through ownership. They are salaried experts, trained by education and experience in the field of management. Though only salaried managers, they find themselves responsible for making the decisions which affect not merely the dividends their stockholders receive but also the prices consumers pay, the wages their workers earn, and the level of output and employment in their own firms and in the economy as a whole.

As far as the facts are concerned, there is nothing startlingly new about these conclusions. They have been sensed by the man in the street, and they are part of the everyday experience of those closely associated with big business. The detailed picture, however, has not been presented before in systematic form, and it has been obscured by loose generalizations about the "control" exercised by influential banking and stockholding groups. It is probably safe to say that the full extent to which professional executives have assumed the mantle of business leadership has not been adequately appreciated, either by economists or by the public generally.

The analysis of the preceding chapters has been confined to the very large corporation, particularly to the giants with assets of 50 million dollars or more. Chapter II indicated how important this segment of the business community is. Actually, of course, our findings are also applicable in some measure to a great many firms smaller than the giants, especially to those whose securities are fairly widely held. Observation of the business scene indicates clearly that delegation of decision-making within management, the power of the executive group and the relative passivity of directors, the incentive system described, and our conclusions with respect

to the power and activities of the various interest groups are not confined exclusively to the very largest corporations. In general, the smaller the firm and the more closely held is its stock, the less should we expect that the leadership conditions we have described would hold. Of course, not all concerns of a given size and a given degree of diffusion of ownership will operate under the same set of leadership conditions. The situation varies from firm to firm.

In the remainder of this chapter we shall be concerned with some of the economic implications of the professionalization of business leadership in the large corporation. The extent of the transfer of the leadership function to salaried managers, the way in which these executives operate, the relative passivity of directors, and the strength or weakness of the various interest groups raise important questions concerning the functioning of our private enterprise economy, the distribution of powers within the corporation, and the impact of larger-scale enterprise upon public welfare.

Thus the "problem" of the small stockholder has occupied public attention for more than a decade and was in good part responsible for the federal securities legislation of 1933-34. Not a little has also been written about the present anomalous position of the board of directors. Outside of management circles, it is generally accepted that the power of the executive group needs to be curbed if stockholders are to be adequately protected. It is also generally assumed that the board of directors should be revivified as an active and independent *decision-making* body, although, as we shall see, there are serious difficulties in putting such a proposal into effect.

These are broad questions of economic policy, full consideration of which lies outside the scope of our study.[1] But the extent to which business leadership has become lodged in the

[1] Another broad question which also lies outside the scope of this study and which we can only mention here concerns the social and economic implications of the declining importance of the owner-entrepreneur as a social class under capitalism. For some provocative remarks on this subject, see J. A. Schumpeter, *Capitalism, Socialism, and Democracy* (1942), Chap. 12.

executive group has a bearing upon these questions, and we shall have to comment upon them briefly in this chapter.

First, however, let us consider another important question. Granted that leadership decisions in the large corporation are made primarily by professional executives, are the decisions which these men make likely to be any different from those which an owner-entrepreneur would make in the same circumstances? We have already stated that there *may* be a difference. Without attempting an exhaustive analysis, we need to look into this question a bit more closely.

FACTORS AFFECTING DECISION-MAKING BY PROFESSIONAL EXECUTIVES

Our reasoning about the working of a private enterprise system has long been predicated on the assumption that the business decisions entering into the leadership function are made by owner-entrepreneurs seeking to maximize profits for their firms and thus for themselves—or at least, if concerns are not managed by their owners, that business leaders will make exactly the same decisions as profits-maximizing owner-entrepreneurs would have made in similar circumstances. While not an unreasonable assumption to make regarding business behavior in a profit system, this is clearly only an approximation of the facts, when we come to deal with the sort of leadership conditions prevailing in the modern large corporation.

Professional executives do not necessarily react to business situations in the same way as owner-managers. The personal attributes, background, and training of the salaried manager are likely to differ from those of the owner-entrepreneur of an earlier day or of most owner-managers operating in the modern industrial scene. The incentive systems to which the two types of business leaders react differ in significant respects. Institutional pressures are by no means the same in the two cases. Finally, the transition from personal to professional management tends to invite more formal and ultimately more bureaucratic patterns of organization. These tend to grow in complexity with the size of the firm. It is in the giant corpora-

tion with which we are dealing that professional management is likely to depart to the greatest degree from the pattern of owner-leadership in the small business concern that has been the basis of much of our economic reasoning.[2] In the pages that follow we shall be concerned with this contrast—in which size, as well as professionalization as defined on page 318, plays a part.

We saw in Chapters IV and V how far decision-making has been specialized and diffused through the various layers of management in the large corporation. In particular, a great deal of the initiation of decisions must come from the lower levels. Are lower-ranking executives as willing and able to pioneer and break from the beaten path as the individual owner-entrepreneur?[3] What are the effects of internal financial controls and other checks and balances, especially those inherent in large-scale organization, as plans are initiated at one level and thread their way upward for approval? Can functional and other departmental executives be expected always to give full consideration to the consequences of particular decisions on the enterprise as a whole? It would be surprising if organizational conditions such as these did not frequently result in decisions significantly different from those which an owner-entrepreneur would make in response to a given set of underlying forces.

There are also important differences between the responses and leadership activities of the chief executive and those of the owner-entrepreneur. We have noted the fact that the chief executive must stress the co-ordinating aspects of this

[2] Of course, the larger the concern the less likely are we to encounter cases of owner-management. Indeed, bigness requires that some entrepreneurial decision-making be delegated to salaried managers. Large size inevitably professionalizes business leadership for two reasons. First, ownership tends to become diffused with increase in size of the firm, requiring a transfer of leadership from stockholders to salaried managers. Secondly, even if ownership is concentrated in one or a few persons, such owners of a very large concern would find it a sheer impossibility to make all the entrepreneurial decisions necessary—hence the need for some delegation to professional managers.

[3] Assuming that the owner of the business himself were able to make the decisions at these lower levels.

job. This co-ordinating function, however, is of minor importance to the ordinary owner-enterpriser who, just in proportion as his business is small and personal, can make the important decisions himself, thus reducing the co-ordinating function to a minimum. As a matter of fact, part of the co-ordinating job imposed upon the chief executive of the large concern is for the small business performed by the external forces of the market.

The professional chief executive in the large corporation must attempt to co-ordinate the decisions of many lesser executives. The larger the firm, the more must original decision-making be delegated. What the chief executive approves depends in good part on what filters up to him for approval. And in exercising his approval function he is likely to apply very broad, particularly financial, criteria. Standards of solvency and liquidity not infrequently take precedence over those of profitability and efficiency. In the very large corporation, the size of the stakes often impels the professional manager to emphasize financial caution at the expense of imaginative and creative leadership.[4] The owner-enterpriser may be more willing to gamble his own money than the chief executive of a great corporation may be to jeopardize the financial empire of which he is trustee. The daring of the owner-entrepreneur may be checked by the investment or commercial banker, but the chief executive of the large corporation is more likely to feel the responsibilities of the financier upon his own shoulders.

In general, the bureaucratic tendencies inherent in large-scale organization lessen the ability of professional executives to perform their functions effectively, even if they conscientiously seek to serve the best interests of the firm. Big business, like large-scale government, tends to suffer from a bureaucratic stiffening of the joints.[5] The result is to impair management efficiency, to create inflexibility of operation and some

[4] These considerations are likely to hold even more for the board of directors, in so far as it is active, than for the chief executive.

[5] See TNEC Monograph No. 11, *Bureaucracy and Trusteeship in Large Corporations*, Pts. 2 and 3.

resistance to change, and to increase the strain placed on the personal and leadership qualities of the chief executive.

On the other hand, the professional manager's emphasis on organization and the organizational techniques permitted by the size of the large corporation have contributed to management's efficiency and have permitted constructive programs to be carried through that would have been impossible otherwise.[6] The management structure within the large corporation has its positive as well as its negative side, so far as its effects upon business leadership are concerned.

In addition to problems of internal organization, top management in the large corporation must also deal with directors and with important outside interest groups. The "institutional environment" of the salaried executive, therefore, differs from that of the owner-entrepreneur, particularly of the small concern. In many companies, of course, the role of the non-officer director is a nominal one. But where the influence or leadership of directors is important, the resulting business decisions may well reflect an undue degree of financial caution. On occasion, they may reflect interests, outside the business, which particular directors wish to further.

From his stockholders and perhaps from powerful banking interests associated with the firm, the chief executive of the large corporation is subject to pressures which the owner-entrepreneur avoids, although on occasion the latter may also have his problems with (chiefly commercial) banks.[7] The large firm with outstanding securities is subject to more government regulation than the small owner-managed concern; its legal problems are more varied, hence the influence of the legal profession is greater; and its management must ordinarily be more sensitive to public opinion. The results on decision-making are two-fold. These influences create additional data which management must take into account in making its decisions. Equally important, the character of the

[6] See what is said on p. 324, below, concerning the professional executive's scientific approach to business problems.

[7] The owner-entrepreneur may also have occasional difficulties with partners or minority stockholders—as, for example, did Henry Ford.

chief executive's job is affected. He must spend a substantial part of his time handling these and other external relations of the firm. For this reason, as well as because of the complexities of internal management organization, he must stress the co-ordinating aspects of his job and leave largely to subordinates the initiation and to some extent even the approval of important operating decisions.[8]

No two business executives are exactly alike. Nonetheless, there are certain characteristics which we can attribute to professional managers as a group, and these attributes condition the business thinking and decision-making of the professional business leader.

The modern corporation executive is better educated and in many respects better trained than the owner-entrepreneur of an earlier or even the present day.[9] With this education and training has gone a marked development of a scientific approach to business problems, as evident in the increasing emphasis on careful planning, the use of advisory and research staffs, the development of accounting techniques and budget procedures, the attention being paid to problems of internal organization and executive personnel, and so on.[10]

Among some professional executives, scientific caution may degenerate into a tendency to play safe. They do not receive the profits which may result from taking a chance, while their position in the firm may be jeopardized in the event of serious loss.[11] This is an aspect of the bureaucratic tendencies

[8] These considerations regarding the importance of external pressures hold not only for the giant concerns we have studied but also for many corporations in the smaller size brackets.

[9] The educational backgrounds of the presidents of 100 large corporations are summarized in *Fortune*, February 1940, p. 61. See also F. W. Taussig and C. J. Joslyn, *American Business Leaders* (1932), Chap. 17, for further data on the backgrounds of corporation executives.

[10] Many large and small concerns, including those managed by their owners, acquire a good deal of specialized managerial services from accounting, management, sales promotion, and similar service companies, and also through trade association channels. Thus many untrained businessmen can benefit in some degree from the knowledge of trained experts without needing to hire them full time. Nonetheless, it is generally true that the scientific approach to management problems is most marked among the larger firms well staffed with trained professional executives.

[11] For further discussion of the tendency among salaried managers to play

mentioned previously making for inflexibility and some resistance to change.

In spite of the better education and training of the professional executive, his general business background may not be as wide as that of the man running his own business. In the lower executive ranks, it is particularly likely to be narrow, while the chief executive himself is apt to have come up through the ranks and to have devoted most of his career to one or a few functions. Even at the top, the latter may continue to be primarily a specialist in his decision-making; hence the dependence on influential directors and bankers for advice, the development of advisory staffs, and the great reliance on management committees and group decision-making.[12]

Of course, the greatest contrast between the professional manager and the owner-entrepreneur lies in the character of their respective stakes in the business. A considerable literature has developed concerning the implications, especially from the point of view of the stockholder, of the separation of management and "control" from ownership.

As we saw in Chapter XIII, management's small stockholdings have significantly diminished the strength of the profits incentive among professional business leaders, and this has been accompanied by a strengthening of the various non-financial attractions which the large corporation has to offer. For example, satisfaction of the creative urge and professional interest in the job compete with profit-making as a guide to action, although profits for the firm remain the primary criterion. Power and prestige for the individual executive are not dependent on the personal receipts of profits, and they are only loosely correlated with profits for the firm.[13]

These considerations regarding incentives raise important

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safe, see P. S. Florence, *The Logic of Industrial Organization*, pp. 197, 219, 224-25. For an overdrawn statement of the same sort of tendency, see Miriam Beard, *A History of the Business Man*, p. 727. The tendency to play safe is, as has been noted, also found among directors.

[12] For further discussion of the limited backgrounds and experience of professional executives, see TNEC Monograph No. 11, pp. 46, 49-50.

[13] See the discussion of non-financial incentives in Chap. 13.

questions. Do professional managements seek always to maximize profits for their firms, and is their distribution of earnings always equitable to stockholders and such as to facilitate the smooth functioning of the economic system?[14] Equally important is the broader question as to what role profits may play in a private enterprise system if they are not the reward for active business leadership. These matters were touched on in Chapter XIII, and we shall revert to them again later in the present chapter.

SOME POSSIBLE ECONOMIC EFFECTS OF PROFESSIONALIZING BUSINESS LEADERSHIP

Basically, the characteristics of large-scale professionalized business leadership outlined in the preceding section may affect entrepreneurial decision-making, and hence the functioning of the economy, in either of two ways. As we have already suggested, there may not be the same emphasis on maximizing profits for the firm and the stockholders, as we should expect from a proprietor running his own business.[15] If this is the case, not only is the stockholder affected but, more important, the economic system does not behave entirely in accordance with the profit rules under which it is supposed to function. Secondly, even if we assume for the moment that professional managers do seek always to maximize profits, the leadership conditions under which they operate may still result in decisions significantly different from those which would have been reached under a different set of leadership conditions. For example, complexities of internal organization may prevent management from exploiting fully every profit opportunity; or the more scientific approach of professional managers may uncover investment opportunities that might have escaped the old-fashioned type of owner-entrepreneur using hit-and-miss methods.

[14] See, for example, N. S. Buchanan, *The Economics of Corporate Enterprise* (1940), pp. 448-49. Buchanan concludes that, on the whole, the economic effects of the separation of ownership and management are not particularly significant.

[15] Actually, two issues are involved here. Management may not seek to maximize profits for the firm. Secondly, given total profits, it may divert

We run into difficulties when we try to evaluate in greater detail the effects on decision-making of the leadership conditions in the large corporation. What can be said lies almost entirely in the field of conjecture; factual evidence is largely lacking; and the tendencies which seem to be at work do not all point in the same direction.

We have already stated our opinion that the goal of profit-making, while still paramount, has been weakened in the large corporation. In view of management's small ownership and the incentive system described in Chapter XIII, it would be surprising if this were not the case. The delegation of much decision-making to specialists in the lower executive ranks, professional characteristics emphasizing security of tenure and interest in the job for its own sake, and possible pressures from non-management groups put further obstacles in the way of complete adherence to the goal of profits-maximization for the firm as a whole.

The profits criterion can never be disregarded by salaried executives. As a minimum, it is necessary to keep directors and stockholders passive.[16] Beyond this, however, the executive group may or may not seek, with every decision to be made, to enlarge profits still further. There is considerable opportunity to follow other goals. Today, executives are not likely to use extensively the criterion of maximum financial gain for themselves.[17] But they may very well adopt, at least in part, such criteria as personal position and power, the desire to see the firm larger, or even more socially desirable goals such as the welfare of workers, consumers, or other broad groups. Perhaps more important, they may seek to some

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some part of them away from stockholders. We are interested chiefly in the first of these problems.

[16] We saw in Chap. 8 how impotent most stockholders are. But directors and large minority stockholders can and on occasion do intervene when profits results are particularly unsatisfactory.

[17] Today executives are prevented by law from trading in and out of their own stock on the basis of "inside" information. A minority, however, exploit their positions to secure the largest possible salary and bonus for themselves. Other opportunities for maximizing personal income also exist. In general, however, executives are much more restrained in this respect than they were before the thirties.

extent to play safe and to avoid some of the change and uncertainty which result from assiduous pursuit of every possible opportunity to increase profits further.

To the extent that salaried executives do not take advantage of every change in profit opportunities, an additional element of inflexibility is introduced into the large corporation's responses to changing conditions—over and above the inertias normally inherent in large-scale organization. In short, such managements are likely not to be as sensitive as they might to short-period changes, which are continually occurring in market conditions and profit expectations—price behavior and other economic variables being affected accordingly.[18] In this connection, large-scale business leadership has shown a marked tendency to concentrate upon long-term strategic considerations, particularly on maintaining the competitive and financial position of the firm. Prices may be maintained or changed, for example, not so much with the specific aim of maximizing profits over some period as to protect a competitive position over the very long run, or investment decisions may be based on a variety of financial and strategic considerations, not all of them concerned with a precise balancing of expected returns against cost.[19] Even long-period profit calculations may be subordinated to such considerations as protecting the firm's position in the industry, plans for further growth, maintenance of a liquid position, and so on.[20]

When we turn to particular types of business decisions—investment and price decisions, for example—it is not easy to

[18] In so far as directors are active, they are likely to add little if anything to making the large firm more sensitive to short-period changes in profit opportunities.

[19] Owner-managers also use such criteria where the size of their firms or other advantages give them the opportunity to do so. However, they are more likely than professional executives to link their strategy directly to some concept of maximum profits for the firm, and they are also likely to pay more attention to short-period market changes.

[20] Executives and many economists would argue that emphasis on these "strategic considerations" merely represents a far-sighted evaluation of profit opportunities over the long-term future. They would argue that maintaining or enlarging the firm's share of the market (say, through the formulation of certain price policies) was merely a way of maintaining or enlarging profits in the long run. This may be true in particular cases. But

assess the significance of the leadership conditions prevailing in the large corporation. If we are to have full employment, business leaders must maintain the volume of private investment, and, to make such investment possible, they must continue to pioneer—with new products, new production techniques, and so on. Is the professional business leader likely to do a better or worse job in this respect than the owner-entrepreneur? The evidence is contradictory.

Offhand, we should expect that the tendencies making toward a less dynamic type of leadership in the large corporation would have a depressing effect upon the volume of private investment. Professional executives, emphasizing care and caution and reacting only imperfectly to the lure of profits, may be slow to exploit new and unfamiliar lines of activity, and even investment in familiar channels may be temporarily postponed if the risks involved seem to be substantial.[21] The desire to play safe is likely to be particularly

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emphasis on these broad strategic considerations may also represent, consciously or subconsciously, a desire to manage a bigger firm and other motives related only indirectly to profits maximization over any period whatsoever. Further, certain non-profit criteria may come to be accepted as representing short-cut approximations to the criterion of maximum profits for the firm. Thus maintaining the firm's position in the industry may be the chief criterion used in determining price policy because this is considered the most effective way of maintaining or enlarging profits over the long run. However, these short-cut approximations tend to be accepted unthinkingly by executives and are frequently used without further consideration as to whether future profits are in fact always furthered thereby.

The need of negotiating with organized interest groups also requires the use of broad, strategic criteria which often cannot be readily translated into a quantitative effect on profits. Management's decision, for example, to accept or reject a proposal for a "closed shop" or to grant a particular wage increase may be made with a view to the "best interests of the firm," but it would be difficult indeed to translate the qualitative considerations which entered into the final decision into any clear-cut forecast of the probable effects on future profits.

[21] It is possible, of course, that dealing with "other people's money" may lead an executive to place a lower valuation on investment risks than would an owner-entrepreneur hazarding his own capital. I have already indicated my opinion, however, that the reverse is more likely to be the case today in the large corporation. The factors making for caution and financial conservatism among salaried executives are likely to outweigh any propensity to take chances because they personally do not stand to incur the losses that may be involved.

important during depressions, but it may evidence itself during other phases of the business cycle.[22]

The bureaucratic nature of large-scale organization also tends to be a restraining factor in this respect. A substantial distance separates the chief executive from the lower ranks of the executive hierarchy, whence must come much initiation of investment decisions, and internal financial controls and the checks and balances inherent in such an organization militate against prompt exploitation of investment opportunities.

On the other hand, some characteristics of a professionalized business leadership should tend to stimulate investment.[23] The professional executive's emphasis upon industrial and commercial research has opened up investment opportunities that would have been missed by an earlier generation of business leaders. Modern management methods, emphasizing full knowledge of the facts and careful estimation of costs and prospective revenues, may uncover investment opportunities promising moderate returns that would have been overlooked by business leaders not employing such modern tools. On the other hand, more careful reckoning of probable costs and returns may lead the professional executive to reject investment possibilities that the old-fashioned entrepreneur

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Such lack of risk-taking leadership as may be evident in the large corporation is not confined to the executive group. Directors also show a tendency to play safe, to emphasize the state of the firm's treasury, and generally "to make decisions that will at least keep their own records clear." (*Fortune*, February 1940, p. 108.) Even more than executives, directors have personally little to gain and much to lose from approving decisions involving a high degree of risk. Among the outside interest groups discussed in earlier chapters, the considerable influence of bankers may also be exerted to restrain risk-taking investment, although the desire of some bankers for new business may on occasion lead them to press management to undertake unwise expenditures.

[22] However, the large firm does not hesitate in depressions to introduce technical improvements which lower costs but which do not involve substantial expenditures or much risk. While not necessarily involving much if any net new investment, these operating economies may put the firm in a good position to exploit new investment opportunities in the late stages of depression and to some extent may offset the lack of risk-taking initiative mentioned in the text.

[23] Of course the mere size of big business, apart from the nature of its management, creates a situation favorable to investment. The size and

might have accepted because of the possibilities of large gain if the venture succeeded at all. The profit-receiving entrepreneur is likely to overvalue small probabilities of large returns.

Long-range planning and the professional executive's ability to ignore to some extent short-run profits expectations may lead to the undertaking of some long-run projects that might not have been made if attention had been concentrated on short-run problems. Further, as noted in Chapter XIII, the urge for greater personal power and prestige and the tendency to identify himself with his enterprise may lead the professional executive to continue expansion even in the face of declining profits prospects.

This urge to expand may result in some maldistribution of investment in the economy as a whole. Frequently cited in this connection is the supposed tendency of large-scale corporate managements to retain an undue share of earnings in their enterprises. If retention of earnings goes so far as to bring the rate of profit on further increments of investment in a particular firm below what could be earned by stockholders through investment in other directions, capital is not being ideally allocated.[24] There is probably a tendency in this direction among the managements of American corporations.[25] But the tendency may be no stronger than among many owner-

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financial resources of a large firm mean that risks can be spread; no single undertaking needs involve a very large part of the concern's capital; and hence the "marginal value" of the funds tied up in a given investment is less than to a smaller concern. The large firm also will have more ready access to the capital markets, and at lower cost, than the smaller concern; its cash and credit resources permit it to undertake projects beyond the financial means of the smaller company; and it can utilize financial procedures and devices which the small firm cannot so readily employ.

[24] Obviously, retention of earnings in the business does not mean that real investment necessarily increases correspondingly. The "reinvested" earnings may go, in some part, into increases in cash or securities or into purchases of existing rather than new fixed assets and inventory.

[25] See N. S. Buchanan, "Theory and Practice of Dividend Distribution," *Quarterly Journal of Economics*, Vol. 53 (1938), pp. 64 ff.; also by the same writer, *The Economics of Corporate Enterprise*, Chap. 9. Various other writers have questioned the advisability and profitability of reinvestment of earnings on the scale practiced by many American corporations, and they have also called attention to the non-financial incentives which may lead corporate managements to reinvest earnings. As Buchanan points out

entrepreneurs, whose devotion to their firms may lead them to continue to plow back earnings (or even to invest new capital) when larger returns could be secured elsewhere.

What is the net effect of these conflicting tendencies upon the volume of new investment—in particular firms and in the economy as a whole? It is impossible to say in the absence of more indication as to the relative weight to be attached to the various factors mentioned. It is clear, however, that professionalized business leaders in the large corporation do not necessarily make the same investment decisions as would an owner-entrepreneur confronted with the same set of underlying conditions.[26] It is also clear that certain characteristics of large-scale professionalized leadership tend to restrain the free flow of investment and innovating decisions. Anything done to remove or offset them would tend to stimulate the volume of private investment.

Similar uncertainty surrounds the question as to whether these tendencies accentuate or mitigate the instability inherent in the economic system. The effects on economic stability of some of the factors mentioned in the preceding pages are not altogether clear; and where the effects are obvious, we do not know to what extent the conflicting tendencies offset each other.[27]

("Theory and Practice of Dividend Distribution," pp. 71 ff.), it is practically impossible to test statistically the profit results which ensue from reinvestment of earnings.

[26] The owner-entrepreneur of a small concern, of course, would never be confronted with exactly the same set of underlying conditions as would the management of a large enterprise. The former would be much more restricted by his market environment, he would not have the same set of technical and financial resources, and so on. (See, for example, note 23, above.) From this point of view, the contrast in the text is unrealistic. Nonetheless, it is significant and needs to be made. As pointed out on page 320, nearly all economic reasoning about our private enterprise system proceeds by asking what action a profit-maximizing owner-entrepreneur would take if he were faced with a particular set of underlying conditions. The purpose of our analysis is to show that the answers thus obtained are not necessarily the correct ones if the decisions are in fact made by professional managers operating in a particular type of leadership organization and reacting to the array of incentives that we have described.

[27] For example, conservatism and careful planning should result in the professional business leader's avoiding some of the excesses of boom periods

We may feel somewhat more confident about our knowledge of the probable effects on price-making of the leadership conditions characteristic of the large corporation. In making their price decisions, corporation executives (consciously or unconsciously) undoubtedly follow in part other goals in addition to that of profit maximization. And even to the

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and should thus mitigate the effects of subsequent depressions. On the other hand, tendencies toward reinvestment of earnings and overexpansion and toward avoiding risk-taking in depression may have the opposite effect. Some inflexibility in the large firm's responses to changing conditions may accentuate maladjustments and tend to lengthen or deepen depressions. Further, the professional managers of our largest firms seem to be as susceptible as any owner-entrepreneur to waves of optimism and pessimism, although we should expect the professional manager's scientific approach, his increasing familiarity with economic processes, and his tendency to take a long-run view of things to exercise a mitigating influence on the cycle. Schumpeter has called attention to the fact that in the large corporation economic progress and the entrepreneur's innovating function tend to become depersonalized and automatized. (See Schumpeter, *Capitalism, Socialism, and Democracy*, pp. 132-33; also his *Business Cycles*, Vol. 1, pp. 96, 108-09). We have given some indication of the extent to which this is true. Following Schumpeter's analysis, the "routinizing" of the innovating function and growth of large-scale enterprise (his "Trustified Capitalism") should significantly modify the factors giving rise to business cycles. (*Business Cycles*, Vol. 1, pp. 96-97, 108-09, 144-45; also *The Theory of Economic Development*, pp. 230, 253.) Presumably, in an economy of very large concerns under professional managements, innovations would be introduced more continuously than in an economy of small concerns; the process of adaptation would go on in part within individual firms and to that extent would not necessarily involve the serious competitive readjustments he envisages; very large firms can and do react to a new situation in ways different from small concerns which have less power to manipulate their environments; there would generally be less resistance to new ways of doing things, and hence the innovations would presumably be carried through more quickly and with less serious repercussions on the economy. Actually, so far as I can see, cyclical disturbances are not less severe today than they were when the very large firm was not particularly important, and waves of innovating and adapting investment show up in the very large as well as in the smaller concern. Professor Schumpeter does not think the giant firm yet covers a large enough sector of the economy to make his theoretical structure inapplicable, but in light of our findings in Chap. 2 we cannot agree with him in this. However, the fact that the large firm modifies his explanation of the way in which business cycles occur does not imply that wide cyclical fluctuations might not also occur in a world of large corporations, although in a different way. It is interesting to note that Schumpeter suggests that increasing familiarity of businessmen with the cycle, along with "trustification," is "the chief reason why the real crisis phenomena . . . are becoming weaker." *The Theory of Economic Development*, p. 253.

extent that the profits goal is adhered to, executives will not necessarily make the same price decisions as would an owner-entrepreneur in the same circumstances.

We have noted the leeway that executives have in adhering to the profits criterion. In view of this and the tendency of large-scale leadership to emphasize strategic considerations such as the firm's position in the industry, prices are certain not to be altered with every change in market conditions and profits expectations. These tendencies making for price inflexibility are strengthened by the probable disinclination of professionalized business leaders to pioneer in the field of price changes, particularly in view of the low level within management at which much initiation of price decisions takes place and the inertias and inflexibilities which result from the complexities of internal organization in large firms. In general, the leadership conditions created by the large corporation make for inflexible rather than flexible prices and for some dissociation of price-making from changes in costs and demand.

Important price decisions are likely to be group decisions, in the making of which various individuals and departments participate. In the large firm, data regarding costs and demand "are not ordinarily transmuted into an entrepreneurial decision through a single mind guided by a total view of the situation; rather they are interpreted by various interests and emerge as a group decision influenced in important ways by the internal organization of the firm in question." Rules-of-thumb and formal procedures determine at what levels and by whom different sorts of price decisions are made; this in turn affects significantly the range of considerations likely to be taken into account in making these decisions.[28]

Of course the competitive conditions surrounding large-

[28] For discussion of some of the issues raised in this and the preceding paragraph, see *Cost Behavior and Price Policy*, prepared by the Committee on Price Determination for the Conference on Price Research (National Bureau of Economic Research, 1943), pp. 18-19, 43-47, 272-74. The quotation in the text is from p. 47 of this volume. Other factors not mentioned in the text and which cannot be fully examined here might also affect the price-making of professional executives. One of these is the professional

scale industry, entirely apart from the question of leadership organization and incentives, profoundly affect the executive's price decisions. In considering pricing in the large firm, however, we need to take into account the leadership factors mentioned as well as such matters as company size, degree of concentration in the industry, extent of product differentiation, and other factors not directly concerned with leadership organization and personnel which are ordinarily cited in this connection.

The reader may care to examine for himself the possible effects of these leadership conditions upon other fields of decision-making. In each case, account must be taken of considerations discussed in the preceding pages. How important these factors will be depends on a variety of circumstances. But given the latitude which the large corporation in any event enjoys in determining its course of action, its leadership setup—particularly its incentive system and its method of delegating and specializing decision-making—will in many cases significantly affect the kinds of decisions made and the consequent functioning of the affected parts of the economic system.

THE ROLE OF PROFITS IN THE LARGE CORPORATION

Let us now consider further a question touched upon in Chapter XIII. With business leadership largely centered in the hands of salaried executives, what has happened to the functions which business profits supposedly perform in a private enterprise system?

The concept of a "profits economy" implies that business profits perform two basic functions.[29] First, the business leader uses profits *for the enterprise* as his fundamental criterion in

business leader's increasing desire for knowledge concerning the nature of his costs and of the demand for his product.

The need for a more dynamic type of price-making in large-scale enterprise is examined in E. G. Nourse and H. B. Drury, *Industrial Price Policies and Economic Progress*, and by E. G. Nourse in *Price-Making in a Democracy*. Both of these volumes consider some of the problems of internal organization and external relations of the large firm with which the present study is concerned.

[29] Profits may be defined as the net income of a business remaining after all contractual costs are met. The peculiar attribute of the income is its

guiding the firm's activities. Prospective profits are the yardstick according to which the desirability of possible lines of action is measured. They perform this function whether they go to the business leader or to passive stockholders. Conceivably, profits could provide a measuring rod for this purpose even if they were appropriated by the government.

Secondly, profits provide an incentive to the profit-receivers to perform some needed economic function. The important thing here is that a particular group benefits by receiving the earnings and is thereby induced to provide a productive service in return. The mere existence of profits on the company's books is not enough; some group must have the right to claim them.

While the tendencies mentioned in the preceding pages have impaired somewhat the ability of profits to perform the first of these two functions in the very large concern, basically profits and profit expectations continue to guide decision-making in the giant as well as in the small enterprise. The second function of profits, however, has been substantially modified in the large corporation by the separation of ownership and active leadership. Business leaders act without necessarily relying on profits for their reward; and a good part of the profits earned by these giant firms—indeed the major part—goes to a group who receives it for doing something other than providing business leadership.

In short, the "profit motive" has taken on a new complexion in the large corporation.[30] The goal of business leadership is still profit-*making* but not profit-*receiving*. Profits still play an

residual nature. Economists distinguish between "gross" and "pure" profits. The former is the entire net income. The latter is defined as the part of net income remaining after allowance for imputed "normal" returns on the owner's capital and personal services, if any, and sometimes after further allowance for a risk premium. For the discussion of this section, "gross profits" is the appropriate concept.

[30] The "profit motive" is sometimes used to apply to the desire of any participant in economic activity, worker as well as business leader or capitalist, for money income, whatever its form. We mean by the "profit motive" the desire for a particular type of money income—profits as defined in the preceding footnote. For a discussion of the changing nature of the profit motive, see Nourse, *Price Making in a Democracy*, Chap. 4.

important role in guiding the exercise of the leadership function, as we saw above, but what is involved here is the *existence* of profits—not their receipt by the business leader.[31]

If profits are not a necessary reward for the exercise of the dynamic function of active leadership, what role do they as personal income play in the large firm?

In the large corporation, profits must be considered a return not for business leadership but for the supplying and risking of capital by owners (stockholders). Profits, by law, must go to the owners; in the large firm, the owners are not necessarily the active leaders; their only peculiar contribution for which the receipt of profits can be considered a return is the supplying of capital under particular conditions of risk-taking. Owners differ from other suppliers of capital in that they supply resources without contractual guarantees or preferred position as to income or repayment of principal. They are the residual claimants.

Viewed in this light, dividends to relatively passive owners might better be termed "non-contractual interest" rather than profits.[32] The stockholder is a supplier of capital, like the bondholder. Both take risks, although those of the stockholder are generally greater.[33] Both types of security holders expect to be rewarded for risk-taking. The bondholder demands a higher promised return from risky enterprise; the

[31] The existence of profits, even though they go to others, also serves indirectly to stimulate business leadership by reinforcing various of the non-financial motives mentioned in Chap. 13. For example, profits are in part used as a standard of creativeness, and a position in a profitable concern offers greater possibilities of power and prestige than does a position in a company which is losing money or is on the brink of bankruptcy. The extent of the correlation between profits, on the one hand, and monetary compensation and non-financial incentives, on the other, was discussed briefly on p. 314, above.

[32] See R. A. Gordon, "Enterprise, Profits, and the Modern Corporation," in *Explorations in Economics: Notes and Essays Contributed in Honor of F. W. Taussig* (1936), p. 314.

[33] But not necessarily greater than those of bondholders in other concerns. For that matter, it does not take a peculiar set of value judgments to argue that the risks assumed by the stockholder are not as great as those borne by the average worker, particularly those arising from insecurity of employment. In this connection, see Nourse, *Price Making in a Democracy*, pp. 41 and 89-90 note.

stockholder takes in lieu of higher contractual income the position of residual claimant to all income remaining after contractual guarantees are satisfied. Interest in the one case and profits in the other are both returns for the economic function of supplying capital with varying degrees of risk.[34] It is true that the owner's risks are of a somewhat different kind than those of the creditor. Nonetheless, when ownership is separated from active leadership, profits can no more than interest be considered a return for the dynamic function of creative leadership.

The lessening importance of the profit motive in the large corporation carries with it certain dangers, which we have already noted. The more dynamic types of leadership tend to be discouraged; an added element of inflexibility is introduced into the firm's responses to changes in its environment; the business leader may to some extent be tempted to substitute personal gain for the profits of the enterprise as a criterion in decision-making. If business leaders are to adhere assiduously to the standard of maximum profits for the firm, society and stockholders must rely increasingly on legal and moral compulsions, a higher plane of ethics among corporation executives, and the operation of various non-financial incentives, especially the creative urge.[35]

Increasingly, however, we are expecting of our business

[34] See, for example, Schumpeter, *Business Cycles*, Vol. 1, p. 104; Nourse, *Price Making in a Democracy*, pp. 89 ff.

[35] In view of the weakening of the profit motive in the large corporation, the question might be raised as to whether it would not be desirable to extend the use of bonus and stockownership plans for executives. Through such procedures, it might be argued, the executive's income would be more closely correlated with current fluctuations in profits, and the executive would be able to share more extensively in the pecuniary results of his leadership activities. Thus a more dynamic and flexible type of leadership might result, and the executive's interests might be more closely correlated with those of stockholders.

We examined this problem in Chap. 13 (note 28), where we concluded that, whatever the theoretical arguments for relating the executive's income more directly to company earnings, the practical difficulties and objections could not be easily overcome, nor were the results that would ensue always obvious. These difficulties and objections exist even though management, rather than stockholders in the large corporation, ordinarily exercise the function which leads to the creation of profits.

leaders that they adhere to other goals in addition to that of maximum profits for the firm. Broader criteria—such as lower prices, maximum output, and, above all, stability and security of employment—are being imposed to some extent through government intervention and the pressures of affected interest groups. Business behavior guided by the profits criterion achieves some of these broader goals only imperfectly. This is probably most clearly evident in the case of stability of employment. To the extent that achievement of these non-profit goals does not follow automatically from use of the profits yardstick, they must of necessity be secondary for the business leader. Profits for the firm and stockholders stand as the primary criterion of the effectiveness with which he exercises his function.[36]

If, however, our economic system should ever evolve to a point where various of these broader non-profit criteria were fully accepted by or were more generally imposed upon business leaders, with such sacrifice in profits for the firm as should prove necessary, the system of incentives developed in the large corporation would need little change. The lessened spur of profits to active leadership would prove a positive advantage. A generous though relatively stable pecuniary compensation, security of tenure, opportunities for self-expression in a job taxing one's abilities, and the lure of power and prestige deriving from position rather than wealth are the chief incentives available to the business leader in the large corporation. These incentives are more conducive to leadership directed toward the broader criteria mentioned than

[36] It may be argued that the conflict between some of these broader criteria and profits maximization need not be as great as appears to be the case. The point is sometimes made that, if businessmen saw more clearly the relation between their firms' activities and the resultant behavior of the economic system, they might realize that closer adherence to some of these broader goals might also result in larger profits for their firms. This position is persuasively taken by E. G. Nourse in his plea for general acceptance by business, particularly big business, of a policy of low prices closely geared to large output and technological improvements. (See his *Price Making in a Democracy*.) For businessmen to behave in this way, it seems to me, there would have to be a single decision-making authority over the larger part of the business community.

they are to leadership aimed at maximum profits for the benefit of a relatively restricted group of which the business leader himself is not an important member.

With respect to the smaller, owner-managed type of enterprise, the issues raised in this section do not apply. While we may question the results which sometimes ensue from too vigorous a pursuit of the profit motive by the owner-entrepreneur, at least it is clear that here profits go to the business leader and thereby provide the primary spur to dynamic leadership in that type of concern.

THE RESPONSIBILITIES OF BUSINESS LEADERSHIP

Mention of the goals toward which large-scale business leadership should be directed raises some basic questions of economic policy. While the development of the large corporation and the diffusion of corporate ownership have centered the leadership function in a group of professional business leaders, the objectives toward which these men should point their leadership are tending to become increasingly confused rather than clarified. And to the extent that there is agreement as to goals, the large corporation does not have an effective machinery whereby business leaders can be readily and continuously held accountable for the attainment of these objectives.

The business leader in the large corporation today finds himself in a somewhat anomalous position. Our legal institutions still impose upon him the primary obligation of seeking maximum profits for the firm and the stockholders. But he is also under strong pressure from various groups—bankers, minority stockholders, large competitors, labor, and so on—to further their particular sets of interests. Cutting across these pressures is the growing demand, from the government and the public at large, that the business leader adopt broad social criteria, aimed at benefiting some of the weaker interest groups and the economy as a whole, in exercising his leadership. To these various sets of goals we must add the personal aims of the business leader himself. These personal aims are

in no insignificant degree non-pecuniary in character, while the receipt of profits from stock held in his own firm tends to form but a small part of the business leader's total money income.

Governmental regulation has, if anything, added to this confusion. Broad objectives have not been clarified, nor has responsibility been fixed for their attainment. Much government regulation aims at the protection of particular interest groups; in relatively few cases are the over-all goals of corporate leadership defined clearly as a guide to government intervention.[37] Further, the increasing governmental controls affecting business leadership have evolved in an environment of property rights which has changed but little. The laws of private property, the dominance of the profit motive, and the theoretical sovereignty of the stockholder are all still basic parts of our institutional structure.[38] They limit the extent to which private business leaders can be held accountable for the fulfillment of non-profit goals. Our legal institutions and mores discourage the open avowal of objectives which seem to conflict with the basic criterion of profits and impose obstacles to acceptance by the business leader of other goals set up by government regulation or demanded by public opinion.

Thus management can honestly protest, even without regard for its own personal interests, that governmental pressures aimed in certain directions force it to violate its basic responsibilities to its stockholders. When executives' personal interests enter, consciously and unconsciously, the objections to the goals laid down by government may become even stronger.

Hence, though the last decade has increased the emphasis on the broader social criteria of business leadership, and though our business leaders have gradually accepted some responsibility for the protection of the interests of labor,

[37] An approach to a clear statement of the over-all objectives imposed upon regulatory agencies and private leadership is found in the railroad industry and, to a less extent, in other transportation and public utility fields.

[38] Compare, for example, A. A. Berle, Jr. and G. C. Means, *The Modern Corporation and Private Property*, Bk. 4, Chap. 1.

consumers, and the community at large, it still remains true that a unified and self-consistent set of objectives for the large corporation has not been clearly formulated. The modern business leader is without a clear-cut set of goals in which he himself believes.[39]

In some way, this conflict will eventually have to be resolved. In clarifying management's responsibilities to the various groups affected by the large corporation, it will also be necessary to redefine the powers of these groups over management and to reconstruct the machinery for ensuring that management's obligations and leadership objectives are adhered to. At present the actual distribution of powers within the corporation is not consistent either with legal theory or with some of the claims which business leaders themselves are coming to recognize. The executive group is stronger, and the board of directors weaker than the law assumes. Some interest groups—the "insiders"—have a power which the law does not recognize at all. The power of the labor group has increased rapidly, but its ability to affect management decisions directly is limited. The mass of the consuming public is from one point of view the weakest group of all, although its collective influence in the market place is of course great. The body of stockholders stand in an anomalous situation. In one sense, their position is very weak, for unless they belong to a powerful minority group their ability to influence

[39] In my opinion, the social and economic horizon of the modern professional executive is somewhat wider than that of an earlier generation of business leaders, although some conflicting tendencies are evident. Education and public opinion have increased the executive's awareness of the broader implications of his work, and emphasis on the creative urge has grown with the professionalization of business leadership. On the other hand, the professional executive frequently tends to concentrate his attention on his position, his job, and his firm; and he may view his job with a craftsman's eye that does not take in all the broader implications of his work. Corporation executives also tend to align themselves with the wealthy and more conservative groups, and their thinking on broader issues is likely to reflect this association.

The actual stand taken by corporation executives on various broad issues is reflected in the polls of executive opinion published in *Fortune*. (See also TNEC Monograph No. 11, pp. 108-09, 116, 120-22, for some discussion of executives' sense of social and economic responsibility.) Reports of annual meetings of various business associations, particularly the National

decision-making is narrowly limited. On the other hand, their position is in one sense very strong. By virtue of their rights of ownership and the primacy of the profits criterion, the corporation is supposed to be run primarily for their benefit.

Whatever redistribution of rights and powers may gradually evolve, the executive group will continue as the active business leaders in the large corporation. Unless they are to be the judges of their own achievements or failures, there must be a check from the outside. Management must be held responsible to the groups it exists to serve. The only continuous and formal check at present, other than that exercised by government agencies administering particular types of regulation, is through the board of directors. The present-day board in the large corporation does not perform this function effectively. This raises the question as to what the board of directors can and should do—and whether as presently constituted it is capable of performing the functions that are or may be assigned to it.

THE BOARD OF DIRECTORS AND ITS RELATIONS TO THE EXECUTIVE GROUP

As we saw in Chapter VI, the board of directors as an independent body does not ordinarily exercise an important

Association of Manufacturers, throw interesting light on the presence or (too frequently) the absence of a broad social outlook among top-flight corporate executives. Annual reports of large firms and the public utterances of important executives have in recent years contained increasingly frequent references to management's obligations to workers and customers as well as to stockholders. Although many such statements are not to be taken literally, they undoubtedly reflect an increasing awareness of management's broader responsibilities. Since America's entry into the Second World War, corporation executives and the leaders of business groups have shown somewhat greater willingness to accept broad responsibilities, for example, with respect to maintaining full employment and avoiding the maladjustments to be expected in the immediate postwar period. In this connection, the organization and work of the Committee for Economic Development, headed by Paul G. Hoffman of Studebaker Corporation, is significant. (The committee's activities may be followed in its monthly bulletin, *C.E.D. News*; see also R. A. Brady, "The C.E.D.—What Is It and Why," *Antioch Review*, Vol. 4 (1944), pp. 21-46). It is not unfair to say, however, that the typical corporation executive's sense of economic and social responsibility is neither as keen nor as broad as it should be in view of the ramifying effects of his leadership upon the economic welfare of various groups in the economy.

part of the leadership function in the large corporation. In so far as they are active, outside directors are primarily financial and business advisers, adding their judgment and experience to that of the executive group but, for the most part, leaving to the latter the job of making the leadership decisions.

In the opinion of many executives, the development of large-scale industry and its concomitant separation of ownership and management have made it inevitable that business leadership should be the responsibility of full-time professional executives, not of infrequently meeting, unpaid directors having only a superficial knowledge of the business. Many officials feel that more active participation in decision-making by the board of directors would interfere with the doing of a good job by management itself and would create conflict between directors and executives.[40]

On the other hand, many non-business observers emphasize the missing link in the chain of control between executives and stockholders. They point to the fact that the board exists to represent and protect the interests of the stockholders, and, to a less extent, of the community at large. To protect these interests, they maintain, the board itself must formulate the objectives of the business, control decision-making by management, and interpret management's responsibilities to stockholders and others. At the same time, it is added, restrictions should be placed on management's power, through the proxy machinery, to select directors at will, and directors must be made to recognize more clearly their own fiduciary relationship to stockholders. With the typical passive board, selected by management itself, there is no adequate check on the

[40] Compare the Conference Board's summary of opinions received from executives regarding the proposed use of professional directors. (National Industrial Conference Board, *Prevailing Practices Regarding Corporation Directors*, Studies in Administrative Control No. 2, pp. 9-10; see the same, pp. 20-22). However, another recent study reports that "the attitude of various top executives to the idea of professional directors is surprisingly favorable." (P. E. Holden and others, *Top-Management Organization and Control*, Stanford University Press, p. 223.) The same study (p. 224) does cite the frequently expressed fear that professional directors "would invade the province of executive management."

executive group. By default, management is made the judge of its own responsibilities to stockholders and the community—subject only to such outside pressure as some recent legislation, the spasmodic influence of public opinion, or, occasionally, action by stockholders' groups.[41]

Various suggestions have been offered to make the board a stronger and more active group. One proposal is to offer additional inducement to able men to become directors and to take a more positive interest in the companies on whose boards they serve. Within the past several years, a number of corporations have offered increased incentives to directors. Directors' fees have been raised in some cases, and a few companies now pay their directors a moderate salary. The inducement most widely adopted in recent years is an indemnification clause to protect directors, companies thereby hoping to offset the reluctance of many men to serve as directors since the early thirties because of numerous stockholders' suits and the increased liabilities placed on directors as a result of the securities legislation of 1933-34.[42]

Merely offering such additional incentives or protection to outside directors can be expected to achieve only limited results. Somewhat more competent men might be secured, and they might take a greater interest in the company's affairs; but they would be unlikely to differ greatly from the type of director to whom we have become accustomed or to supply much dynamic leadership. They would continue to be chosen by management through its control of the proxy machinery, or perhaps by some dominant interest group; and under these circumstances the director's sense of responsibility, whether

[41] For elaboration of these points, see R. C. Patterson, Jr., "Wanted: Directors Who Direct," *New York Times Magazine*, Jan. 21, 1940, and "The Responsibilities of Directors," *Advanced Management*, Vol. 5 (1940), pp. 57-62; W. O. Douglas, "Directors Who Do not Direct," *Harvard Law Review*, Vol. 47 (1934), pp. 1305-34, and *Democracy and Finance*, (1940), Chap. 4; TNEC Monograph No. 11, pp. 23-25, 124-27; National Industrial Conference Board, *Prevailing Practices Regarding Corporation Directors*, especially pp. 10-11; G. E. Bates, "The Board of Directors," *Harvard Business Review*, Vol. 19 (1940), pp. 72-87.

[42] Recent tendencies referred to in this paragraph are summarized in the *New York Times*, May 4, 1941; see also the same, Feb. 1, 1942.

he be active or passive, would probably be turned as much toward management (or some powerful interest group) as toward a large, anonymous body of stockholders. The board would be likely to remain at best an advisory council, with much the same conservative and financial emphasis as in the past, while the leadership function would continue to be exercised by the executives.

The answer to the problem of inactive directors most frequently advanced in recent years is that of the professional director. The proposal is that the board be made up in good part of men who will be sufficiently remunerated for devoting a large part of their time to the affairs of a given corporation, who will have an adequate background of experience in the kind of business involved, and who will serve on the boards of at most only a few corporations.[43] The aim is to professionalize the director as well as the top executive.

This proposal has much to commend it, but taken alone it suffers from two serious weaknesses, which are frequently overlooked. Where management continued to control the proxy machinery, the professional director would be selected much as present directors are—by management rather than by the majority of stockholders. The power of the executive group would not necessarily be weakened, and the working director might conceivably provide no greater protection to the interests of stockholders and other affected groups than do directors of the more conventional type who are reasonably honest and responsible men. The professional director's more intimate knowledge of a company's affairs would, however, afford greater protection against fraud and gross mismanagement by executives. //

Secondly, the more active working directors become, the more closely they resemble the executives now responsible for providing business leadership. A full-time working director is merely another official who is also a director. Wide adoption

[43] For a somewhat fuller statement of the characteristics of the professional director, see Holden and others, *Top-Management Organization and Control*, pp. 19-20, 223; also G. E. Bates, *Harvard Business Review*, Vol. 19, p. 81.

of the proposal for professional directors, particularly if management is able to select the directors itself, may merely make general the situation now found in some companies in which only the executive group is represented on the board. There is less danger of this if the working director is associated with several companies and gives only a part of his time to any one of them. On the other hand, if active professional directors do not in effect become part of the executive personnel, the resulting friction may seriously interfere with the ability of either group to exercise effectively the leadership function.[44]

These difficulties suggest that merely professionalizing the board of directors is not enough to achieve competent business leadership and at the same time the necessary independent check on executives. But before suggesting what further changes may be desirable, we must make clear what it is we want the board of directors to do in the large corporation.

In this writer's opinion, the function of business leadership belongs where it now is—with the executive group. The economics of the large corporation makes inevitable the centralizing of active leadership in the hands of full-time management officials. It is therefore not necessary, and it would probably be inimical to effective and co-ordinated decision-making, to attempt to push the board of directors into active and continuous participation in the performance of the leadership function.

Beyond this, there would still be at least three jobs for the board to do. Management needs and seems to want a group of competent advisers. Secondly, someone must appoint the chief executive and determine his compensation. And, finally, the board should act as "management auditors," reporting periodically on the company's progress and the quality of its leadership. Adequate performance of the last two functions, particularly if at the same time executives accept fully the broad economic responsibilities with which they are being charged, will provide in good part the check on decision-making officials which is now too frequently lacking.

It should not be too difficult to secure a board of active and

[44] Here again the danger is less great for part-time than for full-time working directors.

competent advisers, particularly if legal responsibility for decision-making is unequivocally placed on the executives. Stronger financial and non-financial inducements can be offered to the conventional type of director, or, better, part-time professional directors can be employed. The latter, however, should not be expected to assume final responsibility for decisions made by executives. Responsibility for active leadership should be placed squarely on the shoulders of the executive group, and we should do well to change accordingly that part of our corporation law dealing with the powers and responsibilities of directors and executives.[45]

Now we come to the basic difficulty. Granted that we transfer legal responsibility for leadership entirely to the executive group, a mere board of advisers will not provide the independent check on management necessary to ensure that executive leadership is directed toward objectives which satisfactorily promote the interest of stockholders and of the other groups affected by the large corporation's activities.[46] Even granted a widening sense of responsibility among executives, they cannot be left to determine their objectives and responsibilities as they see fit. At best, the result would be benevolent paternalism; at worst, exploitation of the weaker interest groups in favor of the stronger and of management itself.

Hence there must be some control over executives, even though these men make the leadership decisions themselves. To implement the control necessary, and to provide the de-

[45] Here, as in some other cases, it would be necessary to differentiate between the small and closely-held firm and the large corporation whose stock is widely distributed. I recognize that such differentiation, which should be based on both size and diffusion of ownership, would be exceedingly difficult to apply in practice.

[46] I assume, without stopping to defend the assumption, that executives and directors have obligations extending far beyond those they bear to the stockholding group. These broader responsibilities are being increasingly recognized by executives themselves. In this respect, it is my feeling that many top executives have gone further than most outside directors. The legal conception of the board of directors presumes that the latter exists to safeguard the interests of only one group—the stockholders, who alone may vote for directors. All other groups are assumed to be protected in other ways—none of them involving representation in management or on the board.

sired link between management and all affected groups, the board could continue to have the right to select the chief executive. In addition, it could act as a board of management auditors, reporting periodically to stockholders, other affected groups, and the public at large on the company's progress and the quality of its leadership.

To perform these functions, the board would have to be freed of the possibility of management domination. Given management's control of the proxy machinery, the weakness of stockholders, and the fact that management's obligations are too broad for control to come from any single group, we are led to the conclusion that government intervention of some sort is necessary. Such control would probably be burdensome; the writer is not satisfied with any of the possible forms of government regulation that have suggested themselves; but the logic pointing to the need for government intervention of some sort is incontrovertible, if we want to create a strong and independent board in the large corporation.

We cannot enter into a detailed discussion of the various steps which might be taken to make the board independent. A requirement that a substantial minority or even a majority of the board be public representatives might help, but we come squarely against the question: Who would select these public directors and how would we ensure that they would not be dominated by the officials of the company? Or we could give a government agency, perhaps the Securities and Exchange Commission, the right to approve management selection of directors. There might perhaps be a requirement that certain specified groups would have the right to have representatives on the board. I do not see much point, however, to continuing the anachronism of nominal stockholders' voting on management-selected slates for the board. In effect, the board is ordinarily picked before the stockholders vote; the "vote" consists merely of authorizing management—or perhaps a minority or banking group—to confirm its own selections through the proxy machinery; and, as we pointed out, there are other groups, whose welfare is as intimately affected by the firm's

activities as the stockholders', who at present have no vote at all. A change such as that suggested would represent in good part only a nominal revolution in property rights. The real revolution has already largely taken place; the great majority of stockholders have been deprived of control of their property through the diffusion of ownership and the growth in the power of management.[47]

However it is achieved, we need a new type of board of directors in the large corporation. It should be independent of management and owe its allegiance to no single group within or outside the company. The directors should be competent men with broad vision, adequately paid for devoting a substantial part of their time to the company's affairs. The board should not try to "run" the company. Its members would act in an advisory capacity; they would have the power to remove the chief executive for cause and to appoint a new one; and they would act as management auditors, issuing periodic detailed reports on management's performance which would be based on an intimate knowledge of the business.

With the advice and under the broad supervision of such a reconstituted board, the executive group would be free to direct the business according to its best judgment. It should not have to go to the board for approval of specific decisions; and the board, while offering its advice freely, should not be able to force its views on management unless it is willing to go so far as to request the chief executive's resignation. To achieve a clear-cut allocation of responsibility, however, the

[47] See, for example, Berle and Means, *The Modern Corporation and Private Property*, especially Bk. 2, Chap. 8 and Bk. 4. I see no harm and considerable good in recognizing legally the fact that the typical stockholder has little power and that his primary function is one of supplying capital. Even without voting power, the stockholder would be amply protected by the securities legislation of recent years, an effectively functioning SEC, and the sort of board of directors I suggest. Dividends to stockholders would continue to be paid as now, and stock could be bought and sold exactly as at present. It is true that large minority stockholders would be deprived of power and part of the incentive for their ownership by this suggestion. I believe, however, that this would be a net gain. The economy as a whole has too much at stake in the large corporation to permit such "power behind the throne"—whether wielded by minority owners, bankers, or any other group.

executive group should remain free as long as it is in office to make decisions according to its own best judgment. Efficient business leadership in the large corporation must depend on an able, dynamic chief executive, supported by a competent staff adequately organized and directed. The board's participation in decision-making should consist of advice, not interference. Beyond this advisory function, the board's chief contribution can come from its remaining independent of the executive group and using its independence to safeguard the interests of all the groups the large corporation exists to serve.

APPENDIX A

DATA ON THE IMPORTANCE OF THE CORPORATE FORM AND OF THE LARGE CORPORATION

1. The figures on the importance of corporate activity presented in the table on page 14 represent at best only a series of rough approximations. No explanation of the method of computing these figures is given in Part I of the TNEC Hearings, from which they are taken. Inquiry at the Department of Commerce, where the figures were compiled, elicited the explanatory information lacking in the presentation of these figures to the Temporary National Economic Committee.

The expression "business done," as used in the table on page 14, is apparently intended to represent an approximation to total sales or gross receipts. Actually the percentages given were computed in a variety of ways, depending upon what figures were available for all firms in a given industry. In some cases, apparently the figures are merely sophisticated guesses.

In general, where census data for an industry were available, the item most closely approximating total sales was taken and divided into the corresponding item for corporations as given in *Statistics of Income* or in census tabulations. Thus the figure for mining is derived by taking the ratio of the value of product for mines and quarries under corporate ownership to the total value of product of the entire industry. In some cases, the ratios were based on payrolls. The data are for various years between 1929 and 1937, and it was assumed that the relationships found for these years held also for the year 1937.

The figure for the percentage of business done by corporations in the construction industry was computed by the simple process of taking the ratio of the number of corporate establishments in the industry to the total number of such establishments (in 1930). A ratio based merely on the number of establishments seriously underestimates the importance of the corporate form in this or any other industry, since the average size of corporations is considerably greater than that of unincorporated enterprises. For the figure of 36 per cent given in the TNEC hearings we have sub-

stituted the figure of 60 per cent given by the National Resources Committee.[1] This latter figure was derived by taking the ratio of the value of work done by corporations in the construction industry to total contract construction work, as reported in the United States Bureau of the Census, *Census of Business, Construction Industry*, 1935.[2]

The figures of 100 per cent given for the gas and electric industry and for communications are undoubtedly somewhat too high, but the margin of error here, though unknown, is not more than a few per cent.[3]

2. The table on page 17 presented data on the fraction of total assets held by corporations falling in various size groups. In the discussion of this table, it was pointed out that some corporations did not file balance sheets with their tax returns, and data on assets are not available for these firms. We do, however, have figures on total compiled receipts for all corporations. We can estimate the total assets of all corporations, including those not filing balance sheets, by assuming that the assets of all corporations stood in the same relation to the assets of those filing balance sheets as did the total compiled receipts of all corporations to the total receipts of those filing balance sheets. This assumption was made for each industrial group. Total compiled receipts of all corporations in each industrial group were divided by receipts of balance-sheet corporations. The assets of balance sheet firms were then multiplied by the ratio thus secured to arrive at the estimated total assets of all corporations in each industrial group. The estimated total assets for the various industrial groups were added to secure figures for total assets for all corporations combined and for all non-financial corporations.[4]

The adjusted estimates of total assets, with allowance thus made

[1] *The Structure of the American Economy*, Pt. 1, p. 375.

[2] Vol. 3, p. 34. The same figures are cited in L. S. Lyon and others, *Government and Economic Life*, Vol. 1, p. 495.

[3] The same, pp. 494-96.

[4] This procedure for estimating the total assets of all corporations—that is, by adding the estimated totals for the various industrial groups—is more accurate than the direct estimate which could be secured by taking the ratio of total compiled receipts of all corporations to the compiled receipts of all balance-sheet firms and then applying this ratio to the assets reported by the latter. Thus the receipts of all corporations were approximately 102.5 per cent of the receipts of all balance-sheet corporations. Adding the estimated total assets of the various industries, secured by applying the receipts ratio to the assets of balance-sheet firms in each industry taken separately, we get

for non-balance-sheet firms, were then divided into assets held by corporations in the largest size groups. This was done for each industrial group and for the groups combined. These adjusted percentages are shown in parentheses in the table on page 17. It was assumed that all corporations not filing balance sheets fell in the smaller size groups. The result is to reduce slightly the figures for the percentages of total assets held by the largest corporations from what they were when only balance-sheet companies were considered.

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a figure for total assets of all corporations which is approximately 104.4 per cent of the assets of the balance-sheet firms. In the figure of 102.5, the various industries are weighted according to receipts; in the figure of 104.4 they are weighted according to assets. The two procedures give the same results only if the ratio of receipts to assets is the same for each industry. If the ratios are different for various industries, as they are in fact, then we must estimate total assets separately for each industry and add these estimates to get an estimate for all industries combined. A similar procedure was followed by the National Resources Committee. See *The Structure of the American Economy*, Pt. 1, pp. 291-92.

APPENDIX B

A COMPARISON OF TWO RECENT LISTS OF THE 200 LARGEST CORPORATIONS

Two lists of the 200 largest non-financial corporations have recently been compiled—one by the National Resources Committee for 1935,[1] the other by the staff of the Securities and Exchange Commission for 1937.[2] These will be referred to respectively as the NRC list and the SEC list. There are 151 companies common to both lists.[3] One other company on the SEC list is the successor to one on the NRC list.[4] Of the other 48 companies on the SEC but not on the NRC list, about half are subsidiaries of other companies and for this reason were excluded by the National Resources Committee, which automatically omitted all companies, a majority of whose stock was owned by another corporation.

Inclusion of subsidiaries does not seem warranted in a study of ownership by control groups, and the SEC averages of the percentage of ownership held by dominant stockholding groups is given a substantial upward bias through the inclusion of such companies.

In our own analysis of ownership by "control" groups in Chapter II, we have used the SEC list of 200 companies, corrected

[1] See National Resources Committee, *The Structure of the American Economy*, Pt. 1, App. 10. The itemized list was given only for 1935, but the total assets of the 200 largest were computed for other years also.

[2] This list was prepared for the Temporary National Economic Committee as part of a study of ownership in the very large corporation. See TNEC Monograph No. 29, pp. 3-4 and App. 5.

[3] The SEC states that there were 150 companies common to the two lists (TNEC Monograph No. 29, p. 345, note), but our own count is 151 (including one company which changed its name between 1935 and 1937). The reason why 49 companies on the SEC list were not included by the National Resources Committee is explained in the text of this appendix. It is also possible to explain in most cases why 49 companies on the NRC list were excluded by the SEC. The latter stated that the following types of companies were excluded: (1) firms in bankruptcy or receivership at any time in the period 1937-40, (2) companies facing the prospect of government ownership (chiefly street railways), (3) companies wholly owned by other corporations included in the list (the NRC list includes two terminal companies owned jointly by a number of railroads), and (4) a few companies for which the necessary data were not available in time. (TNEC Monograph No. 29, pp. 344-45). Of these, the first was by far the most important. Exclusion of companies in bankruptcy or receivership took a particularly heavy toll of the railroads. These four reasons for excluding companies from the SEC list account for practically all of the companies on the NRC list which were not included by the SEC.

[4] In yet another case, the SEC list substituted a top holding company (Koppers-United) for the holding-operating subsidiary (Koppers Company) included in the NRC list.

to exclude 24 subsidiaries. Of these, 21 represented cases in which a majority of the voting stock was owned by a parent company, and three were railroads leased and operated by other companies on the list.[5] Of these 176 companies, 150 are on the NRC list.[6] The following tabulation explains why the remaining 26 are on the SEC list but were not included by the National Resources Committee.

Too small in 1935 to be included in the NRC list[7]	15
Asset data probably not available to the NRC	4
Probably considered subsidiaries by NRC although a majority of the voting stock was not owned by another corporation in 1937	2
Railroads in the Van Sweringen system excluded by NRC because Alleghany Corporation was included[8]	2
Excluded by NRC because of its foreign operations	1
Successor to company on NRC list	1
Related company used instead of one on NRC list	1
	26

[5] The three leased lines were the Boston and Albany, the Carolina, Clinchfield and Ohio, and the Morris and Essex, leased respectively by the New York Central, Atlantic Coast Line, and Delaware, Lackawanna and Western.

The 21 other companies excluded are all listed by the SEC as representing cases of majority ownership by another corporation. (TNEC Monograph No. 29, pp. 1497-98.) The SEC actually included in its list a twenty-second company, a majority of whose voting stock was supposedly owned by another corporation. This was Electric Power and Light Corporation. It is true that Electric Bond and Share owned a majority of the common stock of this company, but such ownership represented less than 50 per cent of the total voting power. There were two preferred issues with full voting rights outstanding, and of these Electric Bond and Share apparently owned little or none. (TNEC Monograph No. 29, pp. 882-89.)

[6] We have already stated that there were 151 companies common to the NRC and SEC lists. One of these was Shell Union Oil Corporation, 64 per cent of whose voting stock in 1937 was owned by Batavian Petroleum Company. This company is one of the 24 that we removed from the SEC list on the grounds that it was a subsidiary of another corporation. This leaves 150 companies common to our list of 176 and the NRC list.

[7] The smallest company included by the NRC had total assets of 67.3 millions in 1935. The smallest company in the SEC list had total assets of 62.9 millions in 1937.

[8] In neither of these two cases (Chesapeake and Ohio and Pere Marquette) was a majority of the voting stock owned by another corporation in 1937.

COMPANIES AND INDIVIDUALS CITED
(Excluding authors)

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